

**MUNICIPAL FINANCE:  
ACCOUNTING, BUDGETING  
AND INFRASTRUCTURE FINANCE**

**KRAKOW, POLAND  
PHASE II**

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## **ABSTRACT**

This report documents the second of two field trips to Krakow and Warsaw, Poland by ICMA consultants. The purpose of the trip was to assist the City of Krakow in improving its financial management practices. The report evaluates Polish municipal accounting and reporting systems through comparisons to those of other countries. The report also details the City's efforts to install a computer-based financial management system, and provides a number of technical suggestions for the implementation of the system. Capital financing opportunities are identified in the report, with a particular focus on the Kujawy wastewater treatment project. Lastly, the report includes outlines for in-service training programs in financial management.

## EXECUTIVE SUMMARY

This report is the work product of the second of two field trips to Krakow and Warsaw Poland in July and November of 1993. The results of the first trip were reported in August of 1993.<sup>1</sup> Both trips were under the sponsorship of ICMA, acting as contractor for U.S. AID. This second report deals with the project's further assistance in four subject areas relating to the City of Krakow's (and other Polish cities') financial management practices:

1. An evaluation and comparison of Polish municipal accounting and reporting systems;
2. Installation of a financial management computer system;
3. Potential capital projects for financing, and;
4. Outlines for in-service training programs in financial management.

At the conclusion of the November field trip, the team submitted an Action Plan which, slightly amended, is included in this report. The substance of that Action Plan and that of this report is that despite obstacles, Krakow is making substantial progress in modernizing its financial management systems. While retrospective analysis suggests steps that might have eased the transition, the fact is that the City continues to take the initiative to improve its financial systems and practices. As is detailed in body of the report, the City must operate within the fabric of an evolving political and economic structure. Central government policies and unsettled legal issues can also act as impediments to change.

Among the potential barriers to changing the financial system are the prescribed or traditional methods of budgeting, keeping books and financial reporting. To assess this area, the team examined differences in financial record-keeping and reporting techniques between Poland and other countries and their legal basis. Upon examination, these were not found to be insurmountable and not uncommon to any government when particles of data are regrouped to meet a variety of needs. The characteristics of Polish systems of budgeting, accounting and financial reporting, and auditing, when compared with those found in the United States, Great Britain and France are the subject of extended discussion in section II.

Installation of the computer-based financial management system is moving apace in Krakow, but it will likely be behind schedule in doing all that the gmina wishes it to accomplish. Section III elaborates on the recommendations found in the Action Plan, including follow-up information on the capabilities of the Oracle system that the Polish software firm contractor, Otago, is helping install. Numerous technical suggestions as to the structure of the system and implementation steps are found in that section of the report. The Oracle data-base system is itself evolving, and we suggest that the City of Krakow be in touch with the City of San Francisco in the U.S., which is itself undergoing a similar effort.

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<sup>1</sup> J.E. Petersen et. al. *Assessment and Recommendations Concerning Municipal Finance in Krakow, Poland* August, 1993.

Identification of capital financing opportunities is covered in section IV. Although there is a variety of investment projects that are needed, the relatively large and environmentally and economically significant wastewater treatment project, Kujawy, is the focus of attention. As a leading candidate for possible World Bank assistance, the project is about half way completed, having been started in 1989. Several pre-conditions to establishing the City's creditworthiness and to qualify it for outside credit assistance are set forth in section IV. On many of these, the City is making progress, as is reported. A feasibility report is due out this Spring which will be vital to establishing the creditworthiness of the project. Key questions for financing the Kujawy and other projects revolve around the ability of the City to develop sufficient pledges. Both the Action Plan and the body of the report reiterate the need for competent legal analysis and suggest the possibility of a "project" financing.

Lastly, in section V the report elaborates on suggested curricula for in-service training for those engaged in financial management. It is stressed that both conceptual and applied materials are needed and that best efforts are in the direction of training-the-trainers. Special sensitivity is needed making both the material and training techniques relevant to the Polish situation and in view of the fact that many of those participating are looking at things in a revolutionary way. Furthermore, the injection of a market economy orientation brings such subjects as budgeting and procurement into a new light involving notions of competition and opportunity costs. The training suggestions emphasize what we believe to be the most relevant concepts and offers pedagogical suggestions.

A note on team members and other contributors to this report: The second-phase project team was led by John Petersen, President, Government Finance Group, and consisted of Kimberly Edwards, Vice-President, Government Finance Group, and Julianna Pigey, Consultant. The field work was greatly assisted by Richard Sterbanz, Deloitte Touche, and by George Valais, Vice-President, Government Finance Group, who assisted in developing the training curricula.

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## I. ACTION PLAN

Municipal Finance: Accounting, Budgeting, and Infrastructure Finance: Krakow, Poland (Second Phase Visit, November, 1993).

On the basis of the second phase visit to Krakow, the ICMA/USAID Krakow financial management assistance team is recommending that several next steps be taken in the areas of accounting, financial reporting, budgeting, and financial management improvement. While many subject areas require the gathering of additional data and refinement of conclusions and advice, there are several that lend themselves to the gmina of Krakow taking immediate steps. These we have summarized into action points found in the following subject areas.<sup>2</sup>

### A. Accounting Standards and Financial Reporting

#### *Action Points:*

As indicated below, we suggest that the gmina's work with Otago on the installation of the computer software and data system be such as to ensure the following:

- # the basic prescribed components (Dzial, Rozdzial, Paragrafy) can be further assembled into account groups, programs, departments, and funds;
- # encumbrances can be used to reflect current period resources committed to future expenditure;
- # the City Hall system is made compatible to the degree possible with the existing and future computer capabilities of gmina companies; and
- # the City undertake a liaison with the City of San Francisco which is also installing an Oracle-based system that will have components of a fund accounting system.

Our initial evaluation of the Polish chart of accounts as prescribed by the Ministry of Finance for municipalities indicates that the system appears to be compatible, with certain exceptions, with the accounting systems employed in western Europe and the United States. We hasten to point out that the key issue is the way in which the basic building-blocks of accounting data are assembled and coded. How they are subsequently aggregated and displayed (calculated for various purposes of analysis and reporting) is not the decisive point. In other words, so long as the basic data are reliable and compiled in a system of sufficient flexibility, they may be formulated in a number of ways to produce the desired reports, be they analytical, legal, or reportorial.

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<sup>2</sup> Team members on the visit of October 28 through November 9, 1993 consisted of John Petersen (Team Leader), Kim Edwards, and Juliana Pigey. They were joined by Mr. Richard Sterbanz of Deloitte & Touche (Warsaw) who kindly advised on the computer program installation issues. Ms. Pigey is also a member of the municipal credit project team.

Aside from the analytical improvements that the above steps will allow, we believe that they could be of considerable merit in satisfying future creditors as the performance of particular funds and the greater transparency of accounts. The establishing of crosswalks and roll-ups of these data is technically a matter of how the computer program is constructed as is discussed in the following item. However, we caution that the gmina should think carefully about reaching increasingly higher levels of aggregation and attempt to simplify groups, programs, and funds into relatively large aggregates.

## **B. Installation of Computer System**

### ***Action Points:***

- # We strongly urge that Mr. Sterbanz be engaged to work, from time to time, with the gmina and Otago in the incorporation of the above features into the program for the gmina. His periodic review and involvement will assist in making sure that the architecture of the system will be such as accommodate expanded applications of the accounting and financial reporting system.
  
- # Along these lines, we urge a translation of the City of Rochester NY system Users Guide to provide an overview of the use of the financial parts of the system and early decisions as regards security in the system (i.e. who is allowed to make changes in the system and at what levels). This guide also provides examples of monthly reports and encumbrance accounting. It should be kept in mind that the Rochester system is a mainframe system and has separate payroll (wages and salaries) and purchasing (which includes invoices and encumbrances) systems.

The capabilities of the financial management and accounting system that is being implemented by Otago, Ltd. on behalf of the gmina is an area of immediate concern. Our meetings with Otago (in which we were assisted by Mr. Richard Sterbanz of Deloitte-Touche Warsaw) indicated a willingness to build into the system the greater capabilities discussed above. The basic software program (Oracle) appears flexible to handle both the needs of central government reporting and the greater managerial and reporting demands specified above. In the case of the application of the Oracle software we note that Otago is programming it specifically to fit the Krakow specifications. We also note that accounting and reporting systems using that program's "language" are present in San Francisco, CA. We will obtain reports from, and other information about, the application of Oracle in San Francisco upon our return to the United States and will forward to them to Krakow.

It is our understanding that initial implementation of the Krakow Oracle-based system financial management information system (but not involving the accounting and financial and reporting system) will begin at year end 1993.

The issue of transferability of developed software to other Polish cities is somewhat complicated. On one hand, the system will be superior with regard to its ability to report activities, costs, and financial position and this will be of use to other Polish cities. On the other hand, ICMA/USAID must be careful so as not to lend a peculiar advantage to a particular software firm in developing commercially vendable programs. Our initial recommendation is to proceed with actively assisting

Krakow in developing its installation with Otago and not to attempt an explicit program for the larger application at the behest of USAID. If the system becomes popular and sees wider application, that will be a concern of the gmina of Krakow and the firm of Otago. Nonetheless, it is hoped that the Krakow system will be superior one, demonstrate its worth, and will invite emulation by other Polish cities. We believe that the basic principles will be transferable to other software packages and that supplying vendors will arise to meet the demands.

### **C. Capital Budgeting and Financing**

Based on our discussions with the gmina, various readings, and informal conversations with various authorities, we believe there are several steps that the gmina should take to enhance its opportunities to receive financial credits and other forms of financial involvement:

#### ***Action Points:***

- # In the case of particular major investments, the gmina needs to commission or otherwise provide feasibility studies that support the needs for and the technical effectiveness of the projects, justify their life-cycle costs, demonstrate that projects comport with best organizational and managerial practice, are optimally scaled and can be financially sustainable. In the case of Kujawy sewer treatment project, this type of study has been instigated by the World Bank and will be done by CH2M-HILL.
- # Procurement legislation is needed to be passed by the City to establish regulations to assure that purchasing will be done in a cost-effective way. Once contracted for, it is necessary to assure that there is strict and timely conformance to the contract.
- # A transparent and legally enforceable relationship needs to be established that sets out ownership, management, and financial controls between the gmina and gmina-owned or gmina-assisted companies. To the extent practicable, companies that produce services that are consumed by individuals and firms and directly benefit them should be supported by fees and charges from the benefited parties. This not only helps to regulated use of the service, but also frees up general revenues for publicly consumed items.
- # A Multi-year Capital (Investments) Improvement Plan is needed to guide the selection of projects and to orderly plan for their financing. It is vital that the plan be comprehensive and reflect both the plans of the gmina and of its companies. The gmina has already embarked on such a plan.

Legal analysis is a top priority to ascertaining the ability of the gmina and/or its legal progeny to do three things:

- # Pledge income-producing properties to the repayment of debt obligations (collateralization);
- # Pledge intergovernmental payments (payments from the central government) to debt service; and

- # Use third-party trustees to oversee trust agreements that provide for the collection, safekeeping and lawful distribution of borrowing proceeds and pledged security.

Clarity on the legality of these three points is needed in order to design marketable/bankable credits. Such research is beyond the scope and skills of municipal attorneys and needs to be done independently by a firm well-versed in Polish law.

Last, there needs to be active negotiation with the local credit providers (especially banks) to engage their interest in providing credit to municipal projects and to employ the above features. Our view is that the Kujawy (sewerage treatment at Nowa Huta) project which has tentative support from the World Bank (subject to the above cited efficiency study) would be an ideal candidate for a "project financing that would involve a combination of credit providers. We are aware of similar projects in Poland that are seeking financing options.

The City is in the first year of an effort to collect and phase a multi-year capital plan and budget which is being prepared by the Department of Strategy and Development. This plan will seek to combine both the projects planned by the gmina and the City-owned companies. Our understanding is that the plan is concerned only with needed outlays and has yet to identify sources of financing. Among the major projects that are contemplated are the completion of the Kujawy project, which will require an added PLZ 340 billion to complete (PLZ 70 billion already having been spent). In addition there are major projects to be undertaken in the areas of the heating plant, solid waste disposal, transportation (rail track modernization, electrification, and modern rolling stock), protection of the water supply at the Raba river and various longer-term possibilities such as the circle road bypass around the City and development of the airport.

Establishing projects that can be financed by external sources will depend not only the technical aspects of that particular project, but how it fits into the fabric of improvements needed and how they will be financed. It also depends on assurances as to the ongoing employment of transparent financial reporting and sound management practices.

#### **D. Training in Financial Management**

On the basis of its trip in June/July, the team had identified the following areas as prime candidates for training and/or seminar activity:

- # capital budgeting and finance
- # budgeting processes
- # financial reporting
- # procurement procedures
- # revenue administration

The above subject areas are high priorities for in-service training in the City of Krakow.

### ***Action Points:***

Before discussing our more general recommendations in added detail it is useful to make immediate observations regarding training needs, based on our exit discussions with the City of Krakow Executive Board:

- # *Executive Board Management Training.* Training has been requested for the Board, surveying not only the above areas, but also dealing with time management and the policy importance of the areas. This might be done in the framework of a brief day or two retreat. (Note: ICMA resident advisor Jan Winters facilitated a two day session on these issues in late December. The session was apparently very well received.)
- # *Training for Department Heads and Other Senior Staff.* This would be more extended training on the above topics with greater attention to operational detail. This training is needed to generate bureaucratic support for subsequent training of line personnel and to provide strength in first tier administrators to foster greater ability to delegate and independent decision making. Such training might be done in a series of day sessions over a period of a few weeks to avoid disruption of work schedules. (Note: Jan Winters also facilitated a session of Departments in January. An additional session for the 1,200 remaining Town Hall employees is scheduled for February and will be conducted in conjunction with the Foundation in Support of Local Democracy.)
- # *Training and Technical Assistance in the area of procurement.* This would be done to develop effective City regulations for buying and to move the procurement to a more centralized system in the gmina. Cooperative buying with companies and other gminas is a worthwhile objective.
- # *Economic development and land use planning.* The gmina is anxious to have expert advice on devising economic strategies, putting together effective marketing programs to promote economic activity, and developing financing mechanisms to support public/private development. A possible Urban Land Institute panel on the subject of developing the old and historic area of the gmina.
- # *Capital Improvement Planning and Budgeting.* This would focus on identification of projects, setting priorities, and to analyze financing alternatives. Interaction between the capital budget and the need to meet public health needs, economic development, transportation and the like would be stressed. Such training should revolve around and be supportive of the gmina's emerging capital budgeting exercise. We believe that it would provide good case study materials for broader training work.

In terms of training in general, the team has the following general observations to make:

The several initiatives in Poland regarding financial administration need to be continuously coordinated and cross-fertilized. There are numerous efforts going on and we are in the process of gathering information on presentations made by various instructional units. An FSLD effort on

public finance with Robert Bland and others was conducted last summer with success. In Lublin, we understand that a ICMA unit under Roger Kroh and Kurt Thurmaier recently has made a presentation of budgeting and capital financing that did quite well using participatory techniques. We are obtaining those instructional materials. In addition, the British Know-How Fund has financed a "best practices" manual prepared by Coopers & Lybrand that is quite comprehensive and informational and evidently is assisting the newly formed Regional Audit Chambers (RIO) account with training in the Bydgosc region, if not nationally. Last, the Research Triangle Institute effort in the environmental technical assistance is also developing training modules in conjunction with feasibility studies, rate structure design, financial management structures, financing options, and other topical areas that should be of more general use. These presentation materials, and others as they are identified, should be pulled together and made available "on the shelf" for future instructional purposes.

Instructors in the Polish language are at a premium and efforts need to be made to "train the trainers." Reports on pedagogical techniques indicate that class interaction and case studies, although demanding to put together, are most beneficial. Developing relevant case studies using local finance issues are particularly desirable. These will need to be fashioned as projects move forward. For example, the Krakow capital budget development would appear to be an excellent candidate for developing into a case study as should be the installation of the computer system.

Training support facilities are locally available for Krakow at the Malopolski Institute of Local Government and Administration. That entity while of help in arrangements does not appear to have particular depth in terms of available faculty to teach public finance topics.

## II. EVALUATION AND COMPARISON OF POLISH MUNICIPAL ACCOUNTING AND FINANCIAL REPORTING SYSTEM

### A. Introduction

One recommendation of our earlier report on accounting, budgeting and infrastructure finance for Krakow, Poland<sup>3</sup> is the development of a model for accounting, auditing and financial reporting for gminas. In order to establish the basis and benefits of such a model, this report presents a comparison of standards and practices for budgeting, accounting and external audit in the United States, England, France and Poland.

The accounting and financial reporting practices for these four countries have been established and have evolved in different ways, which is attributable to different models of territorial governance (centralized or decentralized) and of legal systems (legal precedent or common law, as in the U.S. and England vs. codified laws, as in France and Poland). The United States is a much more decentralized system, where reliance on the Federal Government is less pronounced and the role of the 50 Federal States multiplies the models of organization and regulation of municipal governments.

France and Poland have historically known strongly centralized governments, and central control remains important (as for definition of which taxes local governments may implement), even when there is movement to decentralization, through increasing the sphere of local government responsibilities and competence. However, the financing of such transfers of obligations is often through the allocation of central subsidies and grants rather than through expansion of local government fiscal and revenue raising authority. Thus, no local government in either France or Poland has the right to institute sales or income taxes, as is the case for many U.S. municipalities.

The responsibilities of local government vary widely among the four countries. Although police forces are a local prerogative in the United States, all internal security (police and gendarme) has generally been run from and financed by the central government in France and Poland. Education has been organized at the State and local level in the United States, through local school boards. The central government in France defines national curriculum and finances teacher's salaries, but local governments are responsible for maintenance and construction of school buildings. Poland is currently in a transitional stage; the Ministry of Education will continue to define curriculum, but payment of teachers and maintenance of buildings was set to be transferred to gminas on January 1, 1994<sup>4</sup>. The general subsidy distributed to gminas should include a component to finance these expenditures.

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<sup>3</sup> J.E. Petersen et. al., *Assessment and Recommendations Concerning Municipal Finance* August 1993.

<sup>4</sup> As of this writing, the final decision of the new Polish Government on the issue of transfer of education expenditures was not known.

**Table 1: Comparison of Accounting, External Audit and Budgeting for Four Countries**

	POLAND	UNITED STATES	ENGLAND	FRANCE
<u>I. Budgeting Issues</u> A. Budgetary Classification	Defined by Ordinance of the Ministry of Finance	No central legislation covering budgets (classification or codes); Presentation is not uniform. Budget used principally as a management tool.	No central legislation covering budgets (classification or codes). Presentation is not uniform.	Follow the accounting classifications as defined by Ministry of Finance. There are 2 different forms: M11 for communes with less than 10,000 inhabitants; M12 for communes with more than 10,000 inhabitants.
B. Defined Budget Codes	Yes, as defined in ordinance of 4/18/91	No.	No.	Yes, required for all communes, based on the forms M11 & M12 (M14 from 1996)
C. Fiscal Year	January 1 - December 31	Varies by State & local government.	April 1 - March 31	January 1 - December 31
D. Multi-year capital plan	Not currently used by local governments. Most planning is from year to year, as local governments are uncertain as to the amount the central government will be transferred to gminas.	Many local governments prepare 3-6 year capital improvement plans (CIP). The first year of the plan is legally adopted as the annual year capital budget.	Most councils prepare 3-5 year capital plans. These are revised each year, as the central government determines annual borrowing limits per council (based on overall public policy). The central government may also limit the % of capital revenues from property sales that may be spent annually.	Budget is required to be voted on an annual basis. Although local governments may prepare a multi-year capital budget, it may not be included in the budget as multi-year expenditures. For the large projects, communes tend to include the entire cost in the budget and carry-over remaining expenditures to the following years, until project completion.
<u>II. Accounting Issues</u> A. Accounting Standards: 1. Defining body  2. Chart of accounts	Ministry of Finance; Regulation of 12/30/93 on chart of accounts; Regulation of 12/15/91 on principals of accounting  Chart of accounts (Bilans and RB49) required to be completed and sent to Regional Accounting Chamber (RIO)	Generally accepted accounting principals (GAP), supervised by Government Accounting Standards Board (GASB), a not-for-profit non-governmental entity.  Standard are recommended by GFOA, a professional organization. Specific formats may be proposed by different State, but are not uniform nationwide.	Chartered Institute of Public Finance and Accountants (CIPFA). Issues statements of recommended practices and has established a code of accounting practice.  The code of accounting practice is confirmed by legislation, which refers to "proper practice", which had been defined by CIPFA.	Direction de la Comptabilite Publique (Department of Public Accounting), which depends on the Ministry of Finance.  M11 for communes with fewer than 10,000 inhabitants; M12 for communes with more than 10,000; a reform of accounts will be implemented in 1996 (20 communes testing new system as of 1994)

	<b>POLAND</b>	<b>UNITED STATES</b>	<b>ENGLAND</b>	<b>FRANCE</b>
<b>B. Accounting methods</b> 1. Cash/actual	Cash accounting, although the balance sheets do require a form of accrual accounting.	"Modified" Accrual accounting (Government funds); Accrual accounting (Enterprise funds) Some states require a cash basis for accounting; these local governments run two sets of books.	Accrual accounting in most councils; cash accounting in small (Parish) councils	"Modified accrual," based on 13-month year for operating budget. The accounting reform will implement accrual accounting in 1996.
2. Encumbrance/commitment accounting	Not presently used. Encumbrance accounts are available, and used by Central Government	Yes, widely used	In a few councils; depends on the level of computerization.	Yes, widely used.
C. Financial reporting	Reports required by Ministry of Finance and sent to Regional Audit Chamber - resemble budget inscriptions. RB27, RB 30, RB 31, RB 50; Balance sheet - RB 49	Financial reporting standards set by GASB (Pre-1974 were set forth by NCGA. Standards are also promulgated by GFOA (voluntary program)	Contents of financial reports based on code accounting practice. The detail of each presentation is left to each local authority, although certain statements must be included. From FY 1994/1995, local authorities are required to publish performance indicators (which will be audited).	Financial end of year reports currently based on budget codes (M11 or M12). Balance sheets will be required form 1996. The new financial report will be in the form M14. Management accounts required of accountant (Treasury employee)
<b>III. External Audits</b> A. Auditing body	Regional Accounting Chambers (RIO); 17 in Poland	Independent Certified Public Accountants (CPAs); State audit agencies	District Audit Service or private accounting firms, authorized by the Audit Commission	Chambre Regionales des Comptes (Regional Accounting Chambers)
B. Definition of Standards	Parliament; Law of 10/7/92 on the Regional Accounting Chambers Decree of the Prime Minister of 12/9/92 on RIOs.	Generally accepted auditing standards (GAAS), defined by Government Accounting Standards Board (GASB), a professional group.	Enabling legislation to set general principles; Detailed code of practice	Law of 3/2/82 on rights of communes, departments and regions and modifications in Law of 1/5/88
C. Requirements and Frequency of Audits	Complete audit at least once every 4 years (Art. 7, Law of 10/7/92)	Annual audit for compliance is conducted for most local governments. Expanded scope audits (operational, management or performance) may be performed. Annual audits required for government units receiving certain levels of Federal assistance.	Annual audit required (every 2 years for small council)	No stated frequency. All local government budgets are sent to Accounting Chambers for legal compliance examination.
D. Scope of Audit	Accordance with law; accordance with records; Value-for-money assigned tasks	Accordance of accounts with accounting principles (GAP). Evaluation of financial managements. Compliance with legal requirements. Expanded scope audits.	Accordance of accounts with accepted general principles. Evaluation of financial management. Value-for-money.	Verification of Chief Accountant's operations. Evaluation of financial management; compliance with legal requirements.
E. Certification of Accounts	No.	Yes.	Yes.	No.
F. Remuneration of auditors	Auditors are employees of RIOs; no cost is passed on to gminas	By local governments	By local governments; Fixed hourly fee negotiated by Audit Commission and same fee paid by all councils.	Inspectors are employees of Chambres Regionales - no cost passed on to local governments

## **B. Budgeting issues**

Budgets are debated and approved by the governing representative body of the local government; they therefore constitute a legal document which has force of law. The amounts and purposes of spending for the fiscal year which are defined in the budget, may not be changed without a modification deliberated by the local council.

Four characteristics of local government budgets have been identified by the U.S. Governmental Accounting Standards Board (GASB)<sup>5</sup>; these characteristics apply to local government budgets in general and are not specific to the U.S. A legally adopted annual budget : (1) is an expression of public policy, (2) is a financial plan, or an expression of financial intent, (3) is a form of control, and (4) is a basis for evaluating performance.

Budgetary presentations and reports vary widely and only France and Poland have standardized budget codes. There are several techniques of budget preparation and the formula adopted will depend in part on the extent to which the budget is used as a management as well as a financial tool.

The basis of determining authorized income and expenditure include incremental budgeting (use previous budget as a base and increase or decrease by a certain percentage), and zero-base budgeting (start from zero and examine each activity and the level of service to be attained and calculate amount needed to reach this service or performance objective). Budget preparation may be organized in different formats, such as program budgeting, which will emphasize different categories of activities or line-item budgeting.

### ***1. United States***

Local governments in the U.S. generally define the statutes and policies governing their budgets; these statutes may be in the form of a state law for a Federal state, or be included as an item in the City Charter for towns and cities. Such statutes will define the budget process, such as calendar for preparation and approval, as well as requirements for approval.

The format adopted by a local government will depend on whether the budget is used primarily as a financial tool, or is also seen as a management tool; common budget formats may also depend on the technique of preparation. There are no nationally required budgetary classification or budgetary codes for municipalities.

There is no set fiscal year for governmental entities in the United States, and each state and local government will set their own period for their fiscal year; this may vary among local governments

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<sup>5</sup> *Codification of Governmental Accounting and Financial Reporting Standards*, as of June 15, 1987, Governmental Accounting Standards Board, p. 10.

even within a federal state. Most jurisdictions approve annual budgets, although there are some, particularly federal states which prepare biennial budgets (one budget every two years).

Multi-year capital plans are prepared by many local governments, but the entire plan is not formally adopted in the budget. It is the first year of the plan which is legally adopted in the annual capital budget, and annual revision are conducted.

## ***2. England***

Councils in England define the statutes governing their budgets. However, the fiscal year for all councils is uniform and is the same as for the national government (April 1 - March 31). There is no nationally defined budgetary classification and each council determines its own budgetary codes.

Three to five year capital plans are prepared by most councils, similar to practice in the United States. These plans are subject to annual revisions. The implementation of local capital plans depends on the annual borrowing limit which is determined for each council by the central government. Annual limits will be based on an overall public borrowing policy which is applicable to all sectors of government in England. In addition, the central government may limit the percent of capital revenues from property sales which may be spent annually, thus placing further indirect limits on local government capital spending.

Commencing fiscal year 1994-95, implementation of council budgets will need to respond to a series of performance indicators; these indicators will be verified by the annual audit conducted for most councils.

## ***3. France<sup>6</sup>***

Budget documents for French local governments follow the accounting classification of the Ministry of Finance, standardized in budget forms M11 (for commune with fewer than 10,000 inhabitants) and M12 (for communes with 10,000 or more inhabitants). A major difference between these forms is that M11 is a presentation of revenues and expenditures by nature (i.e. -wages, electricity, materials, etc.) and M12 a presentation by activity (education, social services, etc.). These budget and account codes are required for all local governments.

The fiscal year for French municipalities, as for the Central Government is based on the calendar year (January 1 - December 31). All local governments must prepare a forecast budget (budget

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<sup>6</sup> Information on budgeting, accounting and audit issues for French local governments was obtained from conversations with consultants at the French firm Bureau régional d'études économiques et financières (BREEF), as well as from the following books:

R. Dosière and M. Wolf, *La commune, son budget, ses comptes : Guide pratique d'analyse financière*, (Les Éditions Ouvrières, Paris, 1988) and,  
J. Bourdin, *Les finances communales*, (Economica, Paris, 1988).

primitif or BP), which must be approved by the municipal council no later than March 15 of the fiscal year. Each budget must include an operating section and a capital section and each section of the budget is required to be balanced. In principle, French local governments are not allowed to run a deficit.

In the course of the year, the municipal council may vote a supplementary budget (budget supplémentaire or BS), which usually takes place once the final accounts for the previous fiscal year have been approved (compte administratif or CA). The purpose of the BS is to re-authorize and carry-over spending for capital projects underway, as well as include the final results from the execution of the previous budget (i.e. surplus or deficit). In addition, municipalities may vote other changes to the budget through a "décision modificative" (or DM), although they are limited to four such decisions during a fiscal year.

French municipal budgets are required to be voted on an annual basis, for the fiscal year in question. Although local governments may prepare multi-year capital budgets, these plans may not appear in the budget as multi-year expenditures. Thus, for large projects, local governments tend to include the entire cost in the capital section of the budget for the first year of work and carry-over remaining expenditures each year until the project has been completed.

#### **4. Poland**

Budgetary classification and budgetary codes are defined by the Ordinance of the Ministry of Finance of 18 April 1991. In Poland, the budgetary classifications are distinct from the chart of accounts and lead to the production of completely separate reports. The budgetary classification for Polish gminas is based on the national economic nomenclature<sup>7</sup>. It is currently the budgetary classification which is used by managers to follow the financial state of gminas.

Each gmina may define the presentation of the budget to the gmina council as well as any supporting documentation which is considered to be necessary<sup>8</sup>. budgetary presentation. The budget reports that are presented to the gmina council tend to follow the order of the budgetary classification as it has been determined by the Ministry of Finance, and include some additional information and explanations.

Execution of the budget and use of funds transferred from the central government are followed on a regular basis through the filing of monthly, semestrial and annual reports required by the Ministry

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<sup>7</sup> A reform of Polish budgetary classifications is currently being prepared; the new classification will be based on the European Nomenclature of Activities (or European Economic Nomenclature).

<sup>8</sup> *Rzeczpospolita* No. 69, 22 March 1990 p.1. According to Article 53.1, "The procedure of adopting the budget and the kind of degree of detail of information material accompanying the draft budget shall be defined by the gmina council".

of Finance<sup>9</sup>. Gminas complete these reports out of obligation, but do not appear to use them to survey the management of their own budgets.

The fiscal year for gminas is from January 1 to December 31. Although the budget should in principle be voted before December 31, this timetable is difficult to respect, as final decisions on Central Government transfers to gminas have usually not been decided before this delay.

Gmina budgets include both operating expenditures and capital expenditures, but there is no clear distinction between them within the budget presentation, such as a capital "section" similar to French budgets or a capital "budget" as for U.S. local governments.

## **B. Accounting Issues**

Generally, accounting deals with the collection and processing of financial data. These data measure both transactions (flows) and balances (stocks), the latter being organized as assets (resources available) and liabilities and equity (claims on resources and fund balances).

Major distinctions in the ways the accounting "books" are kept and reported have to do with the level of aggregation, the measurement focus and the basis of accounting. *Aggregation* generally deals with the existence of separate funds that support distinct activities or objectives in accordance with restrictions and regulations placed on the raising and disposition of monies or other assets. Thus, a government may consist of a series of separate self-balancing entities known as funds that are separately reported (Fund Accounting). Where the government is presented as a homogenous fiscal entity, there is unified reporting and the implication is that the government is "free" to move resources among accounts (uses) at its volition.

*Measurement focus* relates to the flow of resources to be measured. The major distinction is between "current financial" resources which are available for spending in the current period and "economic resources" which are resources of value regardless of whether they are currently spendable. The distinction is especially important in the case of investment spending and the treatment of debt service. For example, the former definition of focus does not recognize asset depreciation as an expenditure, whereas the latter does take it as an expense.

Closely allied with the concept of measurement focus is that of *basis of accounting*. Here the major distinction is between accrual accounting and cash basis accounting. In accrual, the economic (real) earnings of income and use of resources is recognized as the measurable activities. This gives rise to economic flows that, respectively, add and subtract from the stock of economic assets, whether or not there are monetary flows associated with those events.

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<sup>9</sup> Financial reporting requirements for gminas are defined in the Ministry of Finance Budgetary Law / Ordinance n<sup>o</sup>27 of 14 January 1992, on the principles and timetable of preparing budgetary reports.

In the case of cash basis, only events that give rise to monetary changes in assets and liabilities in the current reporting period are recognized. In the strictest application of cash basis, this means only monetary inflows and outflows (receipts and outlays) are accounted for in the present period.

### ***1. United States***

Accounting standards (i.e., accounting principles and financial reporting) are established by independent standard setting boards: Financial Accounting Standards Board (FASB), Governmental Accounting Standards Board (GASB), National Council on Governmental Accounting (NCGA, pre-1974). Professional organizations such as the American Institute of Certified Public Accountants (AICPA) and the Government Finance Officers Association (GFOA) also participate in the establishment and confirmation of standards accounting and financial reporting.

These standards are voluntary. There is no federal legislation governing accounting standards. Some states may have such legislation or standards which may be imposed at the state level (i.e., states require sub-state levels of government to submit financial reports in a certain format, such as on a cash basis). In instances when a state imposes such standards, governments within the state may also choose to follow national standards, as well.

In the United States, a "modified accrual" system is used for the tax-supported general activities of local governments, which allows for the accounting of revenues at the time taxes are levied and which "encumbers" funds for further outlays that will occur in the future although monetary outlays do not occur in the present period. This encumbrance is effectuated as a restriction against fund balances that are committed for future expenditures. On the other hand, the basis of accounting for governmental enterprises (activities with a business orientation, where "sales" generated revenues are meant to cover costs) is full accrual and for all practical purposes identical to private, commercial activities.

### ***2. England***

For local authorities in England, accounting standards are defined by the Chartered Institute of Public Finance and Accountants (CIFPA), an independent trade association. CIFPA has established a code of accounting practice and will issue statements and clarifications of its recommended practices. This code of accounting practice is supported by national legislation for local authorities, which refers to "proper practice" for public accounting - this proper practice having been defined by CIFPA.

The basis of accounting used by the majority of councils in England and Wales is accrual based; however, cash accounting is used in small Parish councils. Aggregated accounts are in a form of fund accounting; different sectors of activities will be self-balancing, as presented in the financial reports. Despite the wide use of accrual based accounting, few councils use encumbrance accounting; this is said to be partly due to the level of computerization in British local authorities. Current computer programs do not permit encumbrance accounting and most local authorities do not have the financial margins to engage the modernization of their computer systems.

Financial reporting requirements are generally based on the code of accounting practice. Specific statements on the financial reports are required to be included and confirmed by audited certification. Actual details of presentation of financial reports and wording of required statements is left to the discretion of each individual local authority. From fiscal year 1994-95, most local authorities will be required to publish performance indicators, which have been prescribed by the Audit Commission, and which also must be audited.

### ***3. France***

In France, accounting standards are defined nationally by the Direction de la Comptabilité Publique (Department of Public Accounting), of the Ministry of Finance. The accounting standards currently applied by local governments date from 1957 and are based on the then "national chart of accounts".

This national chart of accounts was revised in 1982 and public sectors in France have been slowly revising their accounting standards in conformity with the new chart. The reform for local governments will be applied from fiscal year 1996, although 20 communes will be using these standards in a pilot test from 1994.

The current basis of accounting for French local governments is one of modified accrual, based on a 13-month year for the operating budget. As of 1996, full accrual accounting is expected to be introduced. For the aggregation of accounts, strict fund accounting is not as well-defined as in the United States. Accounts for satellite activities (*régies*) are annexed to the budget, but other forms of organization of local government activities, such as participation in mixed economy enterprises or inter-communal associations and syndicates are not presented with the main municipal budget. Encumbrance accounting is widely used by most local authorities, as the main municipal accounting software packages used in France permit this type of accounting.

Financial end-of-year reports are currently based on the accounting/budget codes in standardized forms M11 and M12 (see Budgeting issues, *supra*).

A specificity of municipal accounts in France is that, although budgets are voted by municipal council and day-to-day accounting managed by municipal staff, the actual payment and receipt of funds is under control of the "comptable" or accountant, who is an employee of the French Treasury (within the Ministry of Finance). Thus at the end of the year, the financial report (*compte administratif*) which is voted on by the municipal council must be reconciled with the management accounts (*compte de gestion*) kept by the Treasury accountant for the commune.

With the implementation of accounting reform in 1996, French local governments will be obliged to set aside funds for depreciation of municipal assets (this is currently practiced to a very limited extent by some local governments), establish a complete listing of municipal assets and liabilities and furnish a balance sheet with end of year financial reports. A greater effort toward presentation of consolidated accounts (or fund accounting) is also expected.

#### **4. Poland**

Polish gminas are required to furnish financial information in two forms - according to the budgetary classification and according to the chart of accounts. These financial presentations are completely distinct.

In Poland, as for France, it is the Ministry of Finance which determines the standards of accounting and the chart of accounts to be used by gminas. These standards have been established by the regulation of the Ministry of Finance of December 30, 1990 covering the chart of accounts (planu kont) and the ordinance of the Ministry of Finance of January 15, 1991 covering principles of accounting.

The basis of accounting for Polish gminas within the budgetary classification is on a cash basis. However, the chart of accounts appears to be based partly on accrual accounting standards. There is currently no overt notion or use of fund accounting by gminas. Encumbrance accounting is not presently used, but its introduction is not precluded by current accounting standards. For the Central Government, encumbrance accounts are available (a "commitment report"). Gminas are not required to complete this report specifically for the Ministry of Finance. but they have the option of doing so for their own internal accounting needs.

Financial reporting by gminas tends to be in the narrow objective of responding to Ministry of Finance requirements to produce specific forms. The majority of these reports are based on the budgetary classification (RB27 for revenues, RB28 for expenditures, RB30 for the accounts of zakad budetowe, special funds and earmarked funds, RB31 for accounts of auxiliary enterprises and RB50 for transfers for activities commissioned to gminas). Two reports refer to the plan of accounts, the RB49 and the Bilans, which are both balance sheets.

#### **D. External Audit**

Financial auditing by external parties may be undertaken to accomplish a variety of goals. The traditional object is to ensure compliance with the law, that funds are raised and expended in accordance with the authorizing legislation and following required procedures. In addition to compliance or legal audit, there may be the additional objective of reporting the financial condition and results of operations. Essentially that means, does the presentation of accounts fairly reflect the governments' financial operations and balances. Such an audit may or may not contain findings regarding the financial condition of the governments (changes in fund balances, solvency, etc.). Last, audits may examine for fraud or speculation - a stealing of funds for personal benefits.

In addition to financial audits, there are audits of the performance of governments in which the effectiveness and efficiency of governments are examined, These are typically undertaken for selected activities upon the request of legislative bodies and are not discussed here.

In all countries examined, the basic motivation of external audits is to determine that funds are lawfully raised, spent and accounted for. In cases of centralized systems, the audit requirements are nationally based. In the case of decentralized systems (the United States), the requirements are state or locally based, since the majority of funds are raised from sub-national sources and that is where accountability resides.

Due to the difference of financing of local governments among the four countries examined, the need and type of external audit required is considerably different. European models of local government are, to varying degrees, more centralized than the American model; central governments play a larger role in defining the legislative and regulatory environment of sub-national governmental entities. Thus rules and regulations pertaining to external audits are also generally determined at a national level.

### ***1. United States***

Legislation requiring audits for U.S. local governments occurs on two levels. At the federal level, the Single Audit Act applies to jurisdictions that receive federal grant money. At the state level, some states may require state auditors to audit jurisdictions (such as the state of Ohio). Other states may require sub-state municipalities to submit audited financial statements so that the state can compile aggregate data.

As a result, some jurisdictions may have no legal requirement to be audited, while others may be governed by state or federal law, or both. Some local governments may have an audit requirement in their City Charter, or may just have one conducted as a matter of policy. Typically, if a jurisdiction is in the capital markets<sup>10</sup> or receives loans or grants from other levels of government, they will be audited.

Auditing standards are set by the AICPA (Generally accepted auditing standards or GAAS) and the federal government (Comptroller General, General Accounting Office).

### ***2. England***

In England, local governments have been audited since the end of the nineteenth century. The audits were conducted by District Audit Services, whose employees were civil servants. In 1984, a completely independent body, the Audit Commission, was created. The District Audit Service lost its civil servant status and auditors became employees of the Audit Commission.

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<sup>10</sup> Many local governments raise money on the capital markets, through the issuance of bonds (long-term financing) and notes (short-term financing). Bonds are one of the principal source of raising capital, due to their tax-exempt status; investors are not required to pay income taxes on interest income from these instruments, which makes municipal bonds an attractive investment.

Most councils are required to have annual audits, though small or Parish councils may be audited only once in two or three years. Since 1984, councils have been able to choose whether to have their audits done by the District Audit Service or by large public accounting firms, which have been certified by the Audit Commission (about six firms have been authorized to audit councils). Currently, about 70% of audits are conducted by District Audit Services and the remaining percent by accounting firms.

It is also only since 1984 that councils have paid for external audits; the hourly rate and the "average" number of days needed for an audit are set by the Audit Commission<sup>11</sup>; all auditors must comply with these rates.

The definition of standards for council audits was established by enabling legislation and detailed in a code of practice, which is followed by all auditors. The scope of audits include verification of balance sheets, whether financial reports are factual and in accordance with accounting standards, an appreciation of council management, and value-for-money analysis. The audit results in a formal certification of accounts.

### ***3. France***

Decentralization of French local governments (communes, départements and régions, associations of communes, new towns, etc.) took place in 1982. At that time, two supervisory bodies were named the Prefect and the Regional Accounting Chambers<sup>12</sup>.

The Regional Accounting Chambers have three main functions pertaining to local governments<sup>13</sup>: (1) propose a budget for a local government if the elected council fails to vote a budget, (2) propose measures to reestablish balanced budget, if end of year results indicate an overall deficit of 10% (communes with less than 20,000 inhabitants) or 5% (all other local governments), (3) conduct on-site verifications of the veracity of revenues and expenditures and that funds are correctly employed.

Based on the third function, the Regional Accounting Chambers do have the possibility of evaluating financial management and issuing opinions on the quality of financial management, based on certain financial ratios, such as the ratio of debt to operating revenues.

All local government budgets and end-of-year accounts must be submitted to the Regional Audit Chambers for verification of legal compliance. Although audits are not prescribed for local governments at regular intervals, the Regional Accounting Chambers will generally intervene when

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<sup>11</sup>The current rate is £50/hour, for a 7-hour day and 5-day week.

<sup>12</sup>Chambre Régionale des Comptes.

<sup>13</sup>Law of 2 March 1982 on rights of communes, departments and regions, modified by Law of 5 January 1988.

it is known that a particular local government is in financial difficulty or there are questions as to the propriety of certain financial activities which may have been undertaken. The result of any audits undertaken are not officially made public; any information revealed on this front has usually been through unauthorized leaks to the press<sup>14</sup>.

As most of the Regional Audit Chambers are understaffed and overworked, it is unlikely that they could even begin to address a requirement for the annual audit of French local governments (of which there are more than 36,000).

#### ***4. Poland***

The Local Self-Government Act stipulated the creation of regional audit chambers (RIO<sup>15</sup>), which are defined as the supervisory authority with regard to gmina budget matters. It was stipulated in this Act that the mode of appointing, organization and detailed principles of operation of RIO's would be defined in a separate act. However, the law regarding RIO's was not passed until 7 October 1992<sup>16</sup> and the chambers were not actually established until March 1993.

Based on the Law of 7 October 1992 and the decree of the Prime Minister of 9 December 1992, the principal responsibilities of RIO's in regard to the financial supervision of gminas include:

1. verifying gmina budgets, on the basis of accordance with law and with factual records, and additionally for tasks delegated to gminas, on the basis of expediency, solidity and efficiency,
2. conducting a complete audit of gmina financial accounts at least once every four years,
3. establishing the gmina budget, if the gmina fails to pass the budget by March 31 of the fiscal year.

Additionally, RIO's are authorized to issue opinions on:

1. the credit repayment capacity of a gmina, upon the request of the bank solicited for the credit,
2. the intent of gminas to issue bonds,

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<sup>14</sup>This is the case for the city of Angoulême, where an audit was conducted following the acknowledgement of a major budget deficit and the inability of the city to meet its debt payments; the results of the audit were made available to the press by the new mayor, who was involved in contentious discussions with the principal banks which had lent to the city.

<sup>15</sup>Regionalna Izba Obrachunkowa

<sup>16</sup>This law is partly inspired from French legislation on Regional Accounting Chambers.

3. drafts of gmina budgets and information concerning the state of municipal property,
4. execution of gmina budgets for the first six months of the fiscal year,
5. actual implementation and financial accounts of gmina budgets,
6. contents of loan and credit contracts which have been signed by the gmina and submitted by the executive board of the municipality.

## **E. Conclusion**

In order to improve management and follow-up of the municipal budget, the City of Krakow has undertaken steps to 1) computerize the budget and several other tasks of the municipality and 2) improve accessibility and readability of accounts, through comprehensive financial reporting (or presentation of consolidated budgets, including all municipal enterprises) and the development of fund accounting.

The current national regulations pertaining to local government finances do not explicitly preclude use of fund accounting and presentation of consolidated budgets. Neither do they explicitly encourage such initiatives. Due to lack of time and training, most Polish gminas have restricted their financial reporting to the presentations required by the Ministry of Finance. However, it is possible to present gmina accounts in a manner which could be used as a management and tool to follow activities and programs as they have been organized by the gmina.

In the context of the current regulations applicable to gmina budgets and account reports, and based on the review of accounting practices in the United States, England and France, it would be feasible for the City of Krakow to introduce forms of fund accounting as well as encumbrance accounting for internal management practices. It is possible to introduce these practices, all the while respecting nationally mandated budget and accounting classifications. Indeed, such a dual-track approach is not unusual in local governments in the U.S. England and France.

The issue then becomes one of presenting the same basic financial information of gminas in two or more different forms: one as required by the Ministry of Finance and one as required to meet the financial and management information needs of policy makers. It should be emphasized however, that in order to be useful, a budget preparation and financial reporting system developed for the City of Krakow, or for any other gmina in Poland must be well thought-out. In addition, it may take a significant amount of time and effort, as well as the commitment of elected officials, to develop and implement such a system.

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## **G. Legislation**

Local Self-Government Act, *Rzeczpospolita*, No. 69, 22 March 1990, p.1.

Law of 14 December 1990 on the revenues of gminas and the rules of their subsidizing in 1991 and 1992 and on the change on the law on the local self-government.

Law of 7 October 1992 on the Regional Audit Chambers.

Decree of the Prime Minister of 9 December 1992 on the seats and the territorial jurisdiction of Regional Audit Chambers.

Regulation of the Ministry of Finance of 30 December 1990 on the chart of accounts

Ordinance of the Ministry of Finance of 15 January 1991 covering principles of accounting.

Ordinance of the Ministry of Finance of 18 April 1991 covering budgetary classifications.

### **III. FINANCIAL MANAGEMENT COMPUTER SYSTEM**

#### **A. Introduction**

In mid-1993 the gmina of Krakow contracted with Otago, Ltd., a computer programming company located in Gdansk, Poland, to develop and implement a computerized financial management system. Otago had developed a database and financial management system for the gmina of Gdansk. The Gdansk system, which will produce the standard reports required by the Ministry of Finance, is intended to be used as a basis for the Krakow system. However, the proposed Krakow system will also incorporate other features that will present financial information in formats that will assist upper management in decision making and implementing program budgeting. Krakow also seeks to improve its financial reporting and accounting practices as necessary to obtain access to the credit markets.

In Phase I of this study, the consulting team identified a number of features that should be incorporated into the computer system. Most prevalent among these included a more comprehensive financial reporting model such as fund accounting that would present all financial activities of the gmina and its various enterprises, as well as encumbrance or commitment accounting that would impose year to year budgetary controls. This section of the report outlines the following:

1. the features of the contract between Otago and Krakow, and the sufficiency of the contract's design specifications in relation to the objectives set forth in Phase I;
2. the capabilities of Oracle to implement these objectives; and
3. recommended enhancements to the contract design specifications to implement the recommended features.

In addition, the following summarizes the status of development and implementation of the project as of the team's field visit in late October-early November, 1993 and recommends future action.

#### **B. Features of Krakow's contract with Otago**

The consultant team reviewed certain portions of Krakow's contract with Otago. In particular, it reviewed those portions that outlined the scope of services of the system and time frame for implementation. The contract set forth thirteen tasks that the computer system will perform. These tasks are summarized in Exhibit A. The text in italics provides a comment as to the tasks' status as of early November, 1993. In general, the primary activities are:

- # Database functions, including a database that will record and track complaints and/or requests for assistance made by citizens to the gmina; an information menu that describes procedures to obtain a service (e.g., how to obtain a building permit) and the organization of City Hall; and a decision making menu for upper management;

- # calculation and administration of various revenues (property tax, property rents and leases, agricultural tax, means of transport tax, transfer tax);
- # general ledger accounting (registration of budget income and expenditures/cash collections and payments)
- # Budget preparation
- # Physical inventory and personnel records for schools

The gmina has also expressed interest in implementing some form of cost accounting into the computer system as well.

Several of these tasks are basic components of the system currently being implemented in Gdansk, including the database for registering and tracking citizen complaints and requests, and the systems to generate the standard forms required by the Ministry of Finance.

The scope of services reviewed by the consulting team did not expressly indicate that the computer system would provide for comprehensive financial reporting/fund accounting, encumbrances or cost accounting. However, Otago has indicated its willingness to enhance the contract to include these features, and during the Phase II fieldwork the consulting team worked with the gmina and Otago to further define the these enhancements. These activities are described in Section C below.

## **Exhibit A: Summary of Scope of Services**

1. Complaint/Request Tracking (requests from citizens for social services, administrative assistance, etc.)
  - a. Register complaint/request and direct to appropriate department/administrative unit
  - b. Identify number of complaints to be tracked
  - c. Review register of complaints
  - d. List according to phase, date, and place

*Program is ready (from Gdansk system), has not yet been implemented.*

2. Decision Making Menu (designed for upper management)
  - a. Cross listing of all units of information on the database
  - b. List all info concerning an issue and any related issues, by issue
  - c. Reference list of acts, laws and regulations concerning an issue
  - d. Budget income (Summary budget reports)
  - e. Budgetary expense (Summary budget reports)
  - f. Full information concerning the client

*Basic questions have been programmed, but waiting for more detailed specifications from the Gmina. Data has not been input.*

3. Information menu for the client
  - a. Required documents and method by which an issue is addressed (i.e., how to get a building permit)
  - b. Description of City Hall organization

*Data not yet prepared (programming is minimal).*

4. Calculation and administration of property taxes
  - a. Register property (using declaration statements submitted by property owners)
  - b. Update registration (type of land use (residential, commercial), type of tax-exemption/abatement and length of exemption period)
  - c. Calculate tax owed
  - d. Record tax payments
  - e. Record payments past due and interest due on back taxes
  - f. Print reports (not yet defined)

5. Calculate and administer property fees (rents/leases, 99-year leases)
  - a. Register property
  - b. Update registration (type of land use (residential, commercial), taxpayer, account card (payment history))
  - c. Record price map, i.e., rent scale by location
  - d. Record rent schedule: date payment is due, date and amount of payments made, back payments due
  - e. Print reports (not yet defined)

6. Agricultural tax (property tax on agricultural land)
  - a. Register property (using declaration statements submitted by property owners)
  - b. Update registration: type of tax-exemption/abatement and length of exemption period
  - c. Calculate tax owed
  - d. Record tax payments
  - e. Record payments past due and interest due on back taxes
  - f. Print reports (not yet defined)
  
7. Means of Transport Tax ("Road tax")
  - a. Register property (using declaration statements submitted by property owners)
  - b. Update registration: type of tax-exemption/abatement and length of exemption period
  - c. Calculate tax owed
  - d. Record tax payments
  - e. Record payments past due and interest due on back taxes
  - f. Print reports (not yet defined)
  
8. Transfer tax (property/estate turnover)
  - a. Register and update land management plans
  - b. Register and update plot values (based on appraisal)
  - c. Edit protocol of purchase (standard sales contract?)
  - d. Register new owners
  - e. Archive previous ownership
  - f. Review real estate and property inventory
  - g. Print reports (not yet defined)

*Items 4-8, output documents have not been defined. Input documents are relatively straightforward - payment made by bank transfer, mail or in person. No programming has begun. Plan to download data directly from current system.*

9. Registration of Budget Income (cash collection/management)
  - a. Register data to payout to cashier (commitment and execution of payment)
  - b. Record cash inflow and outflow at cashier
  - c. Register income via bank transfer with identification of purpose of payment
  
10. Servicing budget expenditures
  - a. Register liabilities and expenditures performed by cashiers and banks (payments are made by either bank transfer or cash)
  - b. Provide reports:
    - expenditure by period by rodzajow
    - overdue payments
    - expenditures by budget task (zadan budzetowych)

*Items 9 and 10 not programmed yet. Working on Design.*

11. Budget Accounting

- a. Service the cashier
- b. Update the plan of accounts
- c. Record turnovers (obrotow) (journal entries/debits and credits?)
- d. Breakdown costs by budget tasks
- e. Service credits (interest owed)
- f. Service funding aims, purposes by budget task
- g. Inventory of funding and aims
- h. Inventory of assets
- i. Service budget subsidies

12. Support planning and the budget

- a. Create budget on basis of what was executed last year
- b. Structure influences that may affect the budget and planned structure of revenues and expenditures according to budget task

13. Education of employees

- a. Administrative
- b. Personnel - job applications
- c. Record of schools - i.e., size of schools, physical characteristics, staff and wages

Otago and the gmina plan to have a system to "register all expenditures" in place by the end of December 1993. Otago is looking for direction from the gmina for specifics for subsystems 9, 10 and 11 described above.

### C. Capabilities of Oracle

The contract between Otago and Krakow states that the financial management system will be an ORACLE relational database system. Oracle Corporation sells several types of software products: the ORACLE database manager (which can be thought of as the programming language), "tools" or software programs that are designed to help programmers write programs/applications in ORACLE;<sup>17</sup> and pre-programmed or "off-the-shelf" applications written in ORACLE. Thus a government that desires to implement a financial management computer system using ORACLE has two choices:

1. purchase the ORACLE database manager and the necessary Oracle tools to write the desired applications, or
2. purchase the applications "off-the-shelf."

The advantage of approach number 1 is that it allows the user to customize the software and incorporate features that may not be available in the "off-the-shelf" version. It can, however, involve higher development costs and longer development periods.

Oracle Corporation offers its products, along with technical support, education, consulting and systems integration services in 92 countries. The ORACLE database manager is a relational database that is considered to be on the cutting edge in terms of software development. It is extremely flexible and can handle very large databases, with fast processing that allows multiple users to operate in a "real-time" environment. In addition, it can operate as well as integrate several different operating systems (for example, IBM and Macintosh). Oracle's "off-the-shelf" applications include a complete set of financial applications, as well as government applications for: general ledger, receivables, payables, purchasing, and revenue accounting. However, as described below, Oracle's applications specific to use by *local* governments in the United States is not very advanced. Otago. Ltd. is developing custom written programs in Oracle for the City of Krakow, rather than using the pre-programmed applications.

The U.S. City of San Francisco has used Peat Marwick's FAMIS system since 1978. Several years ago it adopted Oracle as a *database* standard for all City departments. Two years ago, after reviewing several options for a new finance/accounting system, they signed a joint development agreement with Oracle. The system is still in development and not yet installed in San Francisco.

Basically, Oracle had a commercial accounting package that included general ledger, accounts payable, accounts receivable and some revenue accounting. But they did not have a governmental package *per se*. The joint development agreement with San Francisco was to develop such a package. About a year ago, Oracle became a certified U.S. GAO (Government Accounting Office) supplier to the *federal*

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<sup>17</sup>The programs/applications are a set of directions to manipulate the database to perform the desired function. For example, the database holds all of the accounting data (account numbers and balances); the applications contain instructions to debit or credit an account or perform a year-end close out.

government. Release 9 of Oracle includes some encumbrance accounting and "security" features that presumably allowed it to get this certification. Release 10 (to be available in early 1995) is supposed to be more conducive to fund accounting, i.e. it provides for self-balancing funds, although they are still developing at what level the self-balancing will occur (i.e., account, fund, etc.).

Conversations with City and County of San Francisco staff involved in the project indicated that, overall, in the past two years staff has realized that Oracle did not have a large presence in the governmental market, and probably did not realize the full scope of developing a governmental accounting package (i.e., one fund verses multiple funds) when they signed the joint development agreement.

Since Otago is not using any of Oracles "packages" (they are programming from scratch) the foregoing development may not be that relevant. However, the San Francisco staff did mention the following points that may be instructional as Otago develops the Krakow System:

1. Oracle applications are quite flexible - features such as the "flex-fields" allow multiple charts of accounts/rollups (i.e., one for the City and one for the central government reports). However, they felt it would be extremely difficult to develop the chart of accounts and identify the appropriate flex fields (which is the task that the consulting team started to introduce during our last visit (see Section C below) without the use of an Oracle consultant, i.e. someone experienced with the Oracle applications. They said that in the U.S. these consultants were quite scarce and therefore expensive, but did not know what the situation was like in Poland. It is the consultant's impression from the two field visits that the programmers from Otago were somewhat proficient in this area and appeared willing to offer their input.
2. A government could probably use the Oracle General Ledger package to simply prepare the CAFR. But since it is very powerful and capable of interfacing with the procurement process (i.e., a requisition would automatically set up an encumbrance, etc.) it should try to do that, as well.
3. The City and County of San Francisco outlined three areas that were either causing or going to cause some difficulty:

*Grant Accounting* (i.e., for Community Development Block Grant Funds): Oracle didn't seem to handle this well, but he wasn't aware of the specifics.

*Interdepartmental Services*: It is difficult to record chargebacks for things like data processing, and to handle budgeting for these items.

*Project Accounting*: Oracle has a project accounting package, but it was a very "green product," i.e. in the early stages of development. The main problem was recording on a low enough level of detail for CIP/Public Works projects, particularly those that were grant funded.

The staff also mentioned that San Francisco was having some difficulty using the General Ledger package to prepare the budget, because while the budget may be recorded on a line-item basis, City Council often passes it on a summary level and may impose across the board or departmental level cuts. Thus, it was difficult to go back and apply the cut to each line item.

Based on the experience with the City and County of San Francisco and features of the Oracle products, it appears that Oracle is capable of providing encumbrances, fund accounting and cost accounting. However, it will require substantial time and effort on behalf of the gmina staff and Otago to design the programs and implement them. This is particularly true for the concept of fund accounting. A well-planned design of the funds and account structure is crucial to successful implementation. It appears that the gmina has been moving ahead in implementing the program without thorough analysis of the optimal account structure. We caution that this could jeopardize the future success of the system.

## **D. Design Specifications**

This section outlines several features that should be added to the basic contract in order to implement the recommendations of the consulting team.

### ***1. Account Structure***

Field work during Phase II included recommending an account numbering structure that would help the gmina implement comprehensive financial reporting and/or fund accounting. The basic concept behind this structure is to have an account structure that supports multiple charts of accounts, that is one that posts transactions and produces data according to the Ministry of Finance Reports (BR 27, 28, 49) and one that posts the budget and produces reports according to Krakow's new program budgeting model. This is achieved as follows:

The account number is divided into several fields. One field is used to aggregate data to produce the standard reports required by the Ministry of Finance. Other fields may be used to aggregate data on levels useful to make management decisions, for example, by department or budget program.

In order for this concept to be useful and produce meaningful information, however, the user (the gmina) must carefully analyze its information requirements to determine the appropriate fields, as well the level of detail on which information is needed. The account structure should have the minimum number of fields as possible in order for information to be useful and the software to run efficiently.

The structure developed and recommended to the gmina during Phase II field work is illustrated in Exhibit B. The account number is divided into eight fields. The first three fields would be used to provide management with financial information by fund (assuming the gmina implements a fund accounting system), department, and budgetary program/tasks. The second two fields are used to prepare the balance sheet (Bilans Rb 49) required by the Ministry of Finance, and the last three fields would be used to prepare the budgetary income and expenditure reports required by the Ministry of Finance (Rb 25-27).

The recommended fields are as follows:

#### ***a. Fund***

This field is optional and would only be used in order to implement fund accounting. It would provide management with aggregate level data on all activities financed by the gmina. One logical method to organize the various activities financed by the gmina into funds would be to define fund types and funds based on an entity's legal status/relationship to the gmina. Hence, the budgetary units (jednostka budżetowe) would form one fund type, and each budgetary unit would be a fund; the budgetary enterprises (zakład budżetowe) would be a second fund type, the municipal enterprises

(przedsieboirstwo komunale) would be a third and the workers companies (spolki) would be a fourth. Each legal entity (that is, each budgetary unit, budgetary enterprise, municipal enterprise or company,) would be considered a separate, self balancing fund.

Typically, the field code or number assigned to each fund reflects the fund type. For example, all budgetary units would have numbers between 100-199 (or 1000 and 1999 depending on the number of separate budgetary units); budgetary enterprise funds would be numbered 200-299; municipal enterprises would be numbered 300-399; and companies would be numbered 400-499. Using these fund numbers would allow the gmina to report all activities financed by the gmina in one comprehensive document.

This approach is a substantial departure from current financial reporting practices in Poland. At this time, due to technical and legal restrictions, the gmina may not be able to integrate the financial systems of all activities it funds into a single computer system (for example, the MPK transit company and the WIS water and sewer company have separate stand-alone financial systems.) As an intermediate step, the gmina may defer integrating the financial systems and implementation of fund accounting, but to include the financial statements of all budgetary units, budgetary enterprises, municipal enterprises, and workers companies in one document.

#### *b. Department*

This field would correspond to the organizational structure of the gmina and would allow management to evaluate financial operations on a departmental basis.

#### *c. Program or tasks*

This field corresponds to the programs and tasks used by the gmina of Krakow in their program budgeting efforts. This field would allow management to evaluate the costs and revenues generated by each program.<sup>18</sup>

#### *d. Account Groups*

This field is based on the standard chart of accounts set forth by the Ministry of Finance, which is used by the gmina to prepare balance sheet (Bilans, Rb49).<sup>19</sup> In addition to the group number (for

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<sup>18</sup> This field illustrates the importance of aggregating data to the appropriate level by using the minimal number of necessary fields and account numbers. In preparing the program budget, the gmina breaks each program into tasks (zadan). The program is the most appropriate level on which to record the program budget rather than task (zadan). There are hundreds of "tasks" compared to 10-20 "programs;" thus having a different field for each task would create too much detail, decrease the efficiency of the computer system, and provide less meaningful information.

<sup>19</sup> Commentary to the Standard Chart of Accounts (Komentarz do typowego Kont) written by p. Barbara Bakalarska, Advisor to the Minister of Finance. There is some speculation that the Ministry of Finance may reforming the standard chart of accounts. Programming of the computer system should be flexible enough to allow this change.

example, group 8) this field can incorporate the subaccount numbers (for example, 860) by increasing the number of digits in the field.

*e. Budgetary Classifications*

These three fields are based on the three levels of classification on which the Ministry of Finance requires gminas to report budgetary income and expenditures. These classifications are Dzial (example: Education), Rozdzial (Kindergarten), Paragrafy (line items such as salaries).

In effect, this chart of accounts would allow financial data to be aggregated based on the account groups, budgetary classifications, program budget or departments. However, to implement this structure and protect the accuracy of the accounting data, the gmina staff, in conjunction with the programmers (Otago staff), must develop a list of the number and title of each account in each field. Furthermore, they must develop a matrix that relates the various fields based on the lowest level of detail. For example, each line item ("paragrafy") related to a dzial and rozdzial must be cross-walked to the same line item related to a task and program in the program budget. It is essential that this step be undertaken prior to the commencement of programming.

**Exhibit B: Example of Numbering of Items for Computer System**

## ***2. Encumbrances***

Another recommendation made by the consulting team to the gmina was to implement some form of commitment or encumbrance accounting to control budgetary expenditures from one period to the next. This involves adding a set of "budgetary accounts" to the general ledger and creating a subsidiary ledger to provide supporting detail to each budgetary account. There are three budgetary control accounts that must be added to the general ledger: Estimated Revenues (this account is used as a control against the Revenues accounts), Appropriations, and Encumbrances (these two accounts are used as a control against expenditures). Each of these three accounts is supported by detailed accounts in a separate subsidiary ledger.

### *a. Recording the Budget*

When the City Council passes the budget, the Estimated Revenues account is debited by the amount of revenues expected to be received in that year (the amount of the debit should equal the amount of revenues in the approved budget), and the Appropriations account is credited with the amount of approved expenditures, as set forth in the budget. Any difference between budgeted revenues and expenditures is recorded by a debit or credit to the "Fund Balance" or profit account. (For example, if the budgeted revenues are 1.2 billion zloty, and expenditures are 1.1 billion zloty, then there would be a 0.1 billion profit, recorded as a credit to Fund Balance or the profit account.)

### *b. Recording Expenditures*

When the budget is approved by the City Council, it becomes a legal document that binds all expenditures made by the gmina for that year. Appropriations, Encumbrances and Expenditures are three types of accounts that are used to ensure that the gmina does not spend more than legally authorized by the budget. When the budget is approved, the amount of budgeted expenditures is recorded in the Appropriations account, as described above. When goods are ordered or a contract is signed, the estimated cost of the contract or order should be recorded as an encumbrance, even though no money is spent at the time. An encumbrance is an estimate of the liability (cost) that will be incurred when the goods and services are actually paid for. It is recorded by debiting the encumbrance account and crediting the account "Reserve for Encumbrances." Reserve for Encumbrances is a Fund Balance or profit account. At the end of the year, if goods have been ordered but not paid for, the cost of the goods is set aside in the profit account to be used for payment in the next year. In this way, current year's expenditures are recorded immediately, even if no cash outlay has been made, rather than deferring the expenditure to the next year, when payment is actually made.

When payment is actually made, the entry used to record the encumbrance is reversed (a credit is made to the encumbrance account and a debit is made to the reserve for encumbrance account) and the appropriate expense account is debited, with an offsetting credit to cash or accounts payable.

The system should be designed so that at any given date, comparisons can be made for each item in the Appropriations Budget of the amount appropriated, the amount of outstanding encumbrances, and the cumulative amount of expenditures to date. The net sum of these three items should reflect "Available Appropriations" or "Available Balances."

At the end of the year, closing entries should be made to reverse the entries made to record the budget by debiting reserve for encumbrances and crediting expenditures, and debiting revenues and appropriations, and crediting estimated revenues, expenditures, encumbrances and fund balance.

### *c. Recording Revenues*

When revenues are collected, the revenue account is credited and the appropriate cash or account receivable account is debited. Periodic comparisons between the Estimated Revenues account and the Revenue Account (actual collections) should be made. If certain revenue categories show actual collections substantially below budget, appropriate action should be taken by the City Council to amend the budget.

The above explanation of encumbrance accounting refers to the standard budgetary control accounts used by local governments in the United States. While use of budgetary control accounts does not appear to be prevalent in Polish gminas, interviews with an advisor to the Ministry of Finance<sup>20</sup> indicated that the central government uses some form of encumbrance accounting to implement budgetary controls for the state budget. Thus, the gmina may be able to implement encumbrance accounting using accounts set forth in the standard chart of accounts set forth by the Polish Ministry of Finance, rather than creating a new set of accounts outside of the standard chart of accounts. It is suggested that the gmina and Otago review the accounting practices and accounts set forth in the "Commentary to the Standard Chart of Accounts" by Barbara Bukalarska in the Ministry of Finance to determine the feasibility of implementing budgetary accounting within the existing framework.

### **3. Purchasing**

The executive board of Krakow indicated an interest in developing city-wide purchasing regulations and have purchasing more centralized (i.e., in one place for City Hall, one place for schools, etc.). To the extent that this occurs and the City implements encumbrance accounting, computerization of the purchasing office could increase efficiency and budgetary oversight. For example, the systems could be linked so that whenever a purchase order is generated, an encumbrance would automatically be recorded.

The system should be built with the flexibility to add security checks once purchasing becomes centralized.

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<sup>20</sup> November 8, 1993, Barbara Bukalarska advisor to the Minister of Finance.

#### ***4. Cost Accounting***

The gmina of Krakow also indicated an interest in incorporating some form of cost accounting into the proposed computer system. The accuracy and usefulness of a cost accounting system depends upon the accuracy of the underlying financial data, which is produced by the general ledger system. It is recommended that the gmina does not attempt to install a cost accounting system until the financial accounting/general ledger system is completely operational. Furthermore, much of the information provided by a cost accounting system can also be obtained by incorporating a separate field in the account number structure that identifies the program or task (using the same classifications used in the gmina's program budget), as described in Section 2 above.

#### ***5. Other issues***

During Phase I and Phase II field work, the consulting team identified several other issues that are important to a successful implementation of the computer system. These include:

##### ***a. Organizational support within City Hall***

Identifying a key staff person who will spearhead the project during implementation (acting as the primary contact person with Otago), and be responsible for administering the system once it is implemented. This includes defining the staff who will be available to train and provide support to the other gmina staff who will use the system on a daily basis.

##### ***b. Security***

To protect the accuracy of the data recorded in the computer system, the gmina and the programmers should implement policies and safeguards such as passwords and security keys. The objective of these measures is not to limit user's access to the information stored in computer system (all users should have access to information on a "read-only" basis), but to limit the ability to actually input and change data to authorized users only.

##### ***c. Training***

Otago should provide initial training to all gmina staff who will use the computer system. Training should include written materials as well as interactive, "hands-on" seminars. In addition, after the initial installation and training, Otago should be available to provide ongoing training and refresher courses to current users as well as when new employees are hired in the future. Some of these programs could also be provided "in-house" by gmina staff.

## ***6. The Krakow system as a model for other Polish Cities***

The computerized financial management system that Krakow has proposed incorporates several features that will improve the gmina's financial management practices and consequently the gmina's perceived credit quality, as well. Clearly, design and implementation of this system will be an important precedent to obtaining credit financing, for Krakow as well as other gminas in Poland. Many of the features, such as comprehensive financial reporting and encumbrance accounting, currently are not common practices among Polish gminas and will require extensive conceptual design and programming efforts. It would be desirable for these efforts to be available for the benefit of other Polish gmina's who desire to implement similar practices, rather than each gmina "re-inventing the wheel." Indeed, Krakow's contract with Otago calls for the use of much of the design and systems programming that Otago developed for the gmina of Gdansk.

There are two possible approaches that donor agencies such as United States Agency for International Development (USAID) could take to encourage the implementation of these financial management practices and computer systems in all gminas in Poland.

One approach would be for donor agencies to directly sponsor the development of such software. However, the sponsorship program should be developed in such a way as not to give unfair advantage to a particular programming company or proprietary software language, such as Oracle. USAID could sponsor the research and development for computer software that would implement a certain standard of accounting standards and financial management practices. This R&D could be performed by a not-for-profit consortium of firms, with a provision of funding being that no one firm would have proprietary rights to the software developed. While this approach may produce more immediate results, it may also represent a departure from current USAID policies and practices.

On a more basic and intermediate level, USAID could continue to take a proactive role with central government in legislating changes in accounting standards (for example, by amending the standard chart of accounts to include encumbrance accounts), financial reporting, and financial management practices. In addition, the expanded roles of the Regional Auditing Chambers (RIO) could be used to provide training and technical assistance to implement these changes. Having a standard set of practices formally required by the central government would encourage computer companies to develop software to implement such practices. While this process would be more time-consuming than direct R&D sponsorship, the cost and quality of the product is established in a competitive free market environment.

## **E. Conclusion**

Field work in Phases I and II resulted in recommendations and preliminary design specifications for the proposed computer system. While the gmina has made substantial progress in design and implementation of the computer system without the direct involvement of the consulting team, it appears that much of this effort has been put forth without adequate preliminary design and needs analysis. The involvement of an experienced computer systems consultant who has had direct

experience with the design *and* installation of financial management computer systems to assist the gmina in developing a detailed needs analysis, design specifications and work plan is recommended prior to continued programming efforts.

This consultant could also address organizational strategy issues such as system support, security, and user training.

Secondly, the gmina should pursue the connection with the City and County of San Francisco and to the extent possible, take advantage of the experience of that government in the development of a computerized financial management system using the Oracle database. San Francisco could be particularly helpful in assisting Krakow in the development of the account structure and numbers for each fund, department and program. Interviews with the staff at the City and County of San Francisco indicated that the Oracle corporation had brought prospective users, including the City of Bergen, Norway to observe the development of the San Francisco System. Krakow should contact Ms. Eva Bruce, Project Manager for the City and County of San Francisco if it is interested in having gmina staff and or Otago staff visit the City and/or discuss their projects. (Note: ICMA may be able to arrange a twinning relationship in this regard) Mr. Ed Harrington is the comptroller of City and County of San Francisco and could also be of assistance.

Finally, it is recommended that USAID continue to support legislative/regulatory changes by the Ministry of Finance to require improved financial reporting (fund accounting) and accounting practices (encumbrance accounting). Furthermore, the use of the Regional Accounting Offices to train gmina staff to implement these changes is also suggested.

## **Exhibit C: Implementation Steps for Financial Management Computer System**

Note: These are generic "best practices" (based on Coopers & Lybrand/British Know How Fund Best Practices Manual); however, the City of Krakow has already undertaken several of these steps in the implementation of the "Ratusz." Some of these steps can be performed concurrently, but Krakow should review this list to ensure that it has not bypassed any crucial planning steps.

### ***Developing an information systems strategy***

The gmina should have an agreed upon policy on the selection, purchase and implementation of computer applications. The policy should cover all parts of the gmina, including the spolka, and zaklady budzetowe. The policy should be in the form of an **information system strategy** that sets out the following issues:

1. Scope and objectives of the strategy (example: to computerize City Hall activities, or to integrate existing computer systems in the gmina, including City Hall and zaklady and spolki, such as water company).
2. Existing computer/information systems in the gmina
3. The list of activities and functions to be computerized
4. The type of computer equipment (hardware) to be used
5. A list of implementation priorities (which activities/functions should be computerized first)
6. The structure of the computer department - how many and which City employees will be responsible for administering the computer system and providing training and support to the other City employees who use the computer system in other City departments.
7. A time table or schedule for implementation, which sets out specific tasks, who will be responsible for those tasks.
8. Training of technical staff (City employees in the computer department) and users (other City employees who use the computer system).

To develop an information systems strategy the City staff should conduct an information systems strategy study. The following pages set out the eight steps to conduct the study, develop the strategy and implement the strategy/information system.

## **Exhibit D: Steps to Develop and Implement an Information Systems Strategy**

### **I. PLANNING AND START UP**

#### **A. Objectives**

This phase should identify who will be involved in conducting the information systems strategy study, what each person's roles and responsibilities will be, and the general approach to the study. The team should include representatives from each City department that will use the computer system, as well as the spolki and zaklady that are to be incorporated into the system.

#### **B. Activities**

Identify working group. Hold a meeting to identify the objectives of the study, the approach to the study and each person's role and responsibility. Assign staff to develop detailed project plan. Assign staff to provide general overview of existing computer systems in the City.

#### **C. Deliverables**

A detailed project plan on how the study will be carried out. A schedule of City employees to be interviewed to collect information on existing systems and to identify the needs of the new system. A general review of existing computer systems that have already been installed in the City. A briefing session for City employees to explain the project approach.

### **II. STRATEGIC OVERVIEW**

#### **A. Objectives**

The objective of this phase is for senior management to identify the goals of the system, specifically how they expect the system to improve business practices and performance. The purpose of this phase is to orient the team to the key objectives, rather than spend time and effort on less important or fruitful objectives. This is a relatively short phase and can be done concurrently with phase 1.

#### **B. Activities**

Further review of existing initiatives, including efforts of other cities. Obtain staff input on usefulness of current information systems used by the City. Identify primary opportunities for improvement - i.e., how can the new system improve upon the old system, Identify the key activities/departments to focus on in the remainder of the study.

#### **C. Deliverable**

Outline of goals and constraints; list of activities/departments on which future efforts will focus.

### **III. ANALYSIS OF CITY'S OBJECTIVES**

#### **A. Objective**

Produce a model of the City's activities and the information systems required to support these activities. This will formulate the basic specifications for the computer system.

Activities: Interview City employees that are involved in the activities that will be supported by the computer system to identify needs and requirements of the system. Hold group workshops to validate the findings of individual interviews. Construct models or diagrams that illustrate how activities are carried out and the flow of information within the City.

#### **B. Deliverables**

Models or diagrams that illustrate the flow of information. General specifications of the functions/activities performed by the City and the related needs/requirements of the information system to support those functions and activities.

### **IV. REVIEW OF CURRENT/EXISTING SYSTEMS**

#### **A. Objectives**

The objective of this phase is to identify how existing systems can be enhanced or integrated into new system. This phase can be done in conjunction with phase 3, since they draw upon the same source of information.

#### **B. Activities**

Compare needs and requirements to current systems and identify any gaps; assess the functional and technical quality, as well as the capacity and security features of the existing systems.

Identify which components of the existing systems should be maintained and integrated into the new system, as well as the components of the existing system that should be eliminated and replaced by the new system.

The interviews in phase 3 should also identify the level of skills, experience, and interest of the City staff that will be implementing and supporting the system (computer department staff) and of the City staff in the various departments that will be using the system (the "users"). Identify the level of expenditures on existing and proposed computers. Identify any short-term improvements that can be made in existing systems until they are enhanced or replaced by the new system.

### **C. Deliverables**

Assessment of the quality of existing systems and their "fit" with current and future requirements and technology requirements. Short-term action plan for immediate improvements projects.

## **V. IDENTIFY POSSIBLE SYSTEMS**

### **A. Objectives**

The objective of this phase is to select the appropriate system and method to implement the system (i.e., have in-house staff program the system or purchase a system or programming system from a private vendor).

### **B. Activities**

Issue a request for proposals from vendors. The request should identify proposed applications and data architectures (what data is required and what systems will be needed to process data), as well as a diagram of information flows within the City and between the City and external organizations (central government). Develop a system to evaluated proposals and select a vendor.

### **C. Output**

Request for proposals; Proposal evaluation report; presentation of recommendation to governing body (City Council).

## **VI. COST/BENEFIT ANALYSIS AND IMPLEMENTATION PLAN**

### **A. Objective**

The aim of this phase is to identify options for developing the system and to select the most cost effective approach.

### **B. Activities**

Develop detailed specifications for the system, including inputs, transactions and processes, and outputs/report design. Identify technical options for building the primary system. Defining the skills, organization and management structure required by each option. Defining key performance indicators against which information systems can be reviewed (see attached). Conduct cost benefit analysis of each option. Set priorities for which components of the system should be implemented first.

### **C. Deliverable**

Cost benefit analysis that identifies preferred option. Detail system specifications. Description of a proposed information system organization (computer department), including recommendations for recruiting and training staff.

The Ratusz should be able to interface with existing computer systems within the gmina and zakłady budżetowe or spółki (budgetary enterprises or City-owned companies): Water Company computer system, transit, and existing gmina demographic system, and budget system.

## **Exhibit E: Developing System Requirements and Workplan**

### **A. Essential Features: Accounting and Financial Reporting Issues**

1.
  - a. Able to generate financial statements and reports on a fund basis
  - b. Provide encumbrance accounting
  - c. Support Modified Accrual System
  - d. Support Fiscal Year & Multi Year Funds
  - e. Transaction Driven (posted journal entries are retained)
2. Provide for posting of transactions using chart of accounts required for Ministry of Finance reporting while supporting alternative sortations and summations using translations tables.
3. Provide for matching expense and revenue budgets with actual for reporting of budget status based on organizational responsibility.
4. Ability to support multiple charts of accounts (example: one to submit reports to Ministry of Finance and one to produce management reports for use by City staff.)

### **B. Requirements Analysis**

1. Identify features of account structure (chart of accounts)
2. Identification of inputs, transactions, and document (report):
  - Appropriation (records budget)
  - Appropriation Transfer (from/to)
  - Encumbrance
  - Encumbrance Change (increase/decrease/cancel)
  - Journal Entry (debit/credit)
  - Expenditure based on encumbrance
  - Expenditure - direct claim (not encumbered)
  - Payroll Expense
  - Cash Journal
  - Cash Collection
  - Cash Disbursement
3. Identification of processes
  - posting expense and revenue transactions
  - posting general ledger transactions
  - posting of encumbrance transactions
  - posting of budgetary appropriations

4. Identification of outputs
  - Ministry of finance forms
  - Budgetary reports by organizational responsibility
  - Balance Sheet and Fund Balance Reports for financial
  - On-line inquiry of account balances and transaction detail for departments

### **C. Comparison of requirements to the standard system capabilities**

1. Expense & Revenue Budget Reporting with Encumbrance (Note: There may be a way to develop support for budget preparation by the input of accounts and amounts for the new year so that standard system features could be used to modify, sort, and sum the departmental request.)
2. General Ledger Reports (assets, liabilities, and equity)
3. Cash Disbursement
4. Cash Ledger
5. Fixed Assets

### **D. Analysis of potential modifications**

1. Analyze potential workflow modifications
2. Capabilities that could be developed easily by the finance department analysts outside base system (with a generic spreadsheet and/or database package):
  - a. Capital Improvement Program
  - b. Indirect Cost Allocation (for cost recovery of overhead)
  - c. Cost Accounting (as needed for chargebacks & analysis)
3. Interfaces (monthly feeds) could be developed from other systems:
  - Tax receivable
  - Payroll
4. Determine required system modifications

### **E. Detailed modification feature specifications: Contractual Performance Issues**

1. Provide efficient methods of input with system edits and processing controls that will maintain control of data and the integrity of account transactions and data.
2. Provide efficient methods to generate output.

3. Provide complete system and user documentation and training.
4. Develop procedures for system backup and restore
5. Provide source code as property of gmina

## **IV. IDENTIFICATION OF POTENTIAL CAPITAL PROJECTS FOR FINANCING**

### **A. Introduction**

In our initial assessment of needs, we identified the need to obtain specific information regarding the credit resources from potential lenders including the World Bank, the European Development Fund, and other domestic and foreign sources of capital. There being little private sector or bank lending in Poland at present, and no such thing as a domestic securities market for subnational government obligations, there are many questions regarding how local governments might provide security for or market their obligations. What there is of existing municipal bond laws appears very restrictive and the laws are virtually untested.

More evident are the substantial unmet capital needs. Organizing the needs, quantifying them, and setting priorities among them are all necessary exercises that are just beginning. In the case of Krakow, a capital budgeting process as begun, although the problems of new technology and procurement practices coupled with the economic uncertainty and overriding stringency of resources make the process a difficult one. Another major problem lies in the transitory and unsettled status of state-owned companies that are either becoming local budgetary enterprises, being spun off into separate stock companies or being dissolved and supplanted by private-sector entities. Throughout the structural turmoil, the need for accommodative legislation and for constructive precedent is clear.

Although the initial report provided a number of potential projects, that which has greatest immediacy and perhaps the best prospects for credit financing is the Kujawy wastewater treatment facility which is in the process of being constructed and is under consideration for funding from a variety of sources.

### **B. Kujawy Sewer Treatment Plant**

Investments in the water/sewer sector currently have the highest priority for Krakow. This is due in part to the adverse environmental impact of the lack of sewerage treatment capacity, as well as the necessity of ensuring safe sources of potable water. Among the major projects, planned and underway in this sector, the City is seeking to complete construction of the Kujawy sewerage treatment plant at Nowa Huta. The total estimated cost of this project is 1,000 billion PLZ<sup>21</sup>, of which 64% is financed by the City of Krakow and 36% by the Nowa Huta Steel Mills. Work on the treatment plant commenced in 1989.

In November 1993, it was not indicated exactly how much had been spent on the construction of the plant since 1989, although some of the funds have been apparently used for other works, such as the

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<sup>21</sup> According to one of the Vice-Presidents of the city; the Water - Sewer Company has estimated the cost at 500 billion PLZ, which is \$25 million U.S.

construction of apartment housing. It was indicated that a further 350 billion PLZ is required to complete the work. The completion date has been set for 1996. The City's share of investment costs are financed through own funds. However, the City did contract a loan of 40 billion PLZ from the National Fund for Environmental Protection (NFEP) at a subsidized interest rate of 8%. In order to complete the work on this project as quickly as possible, Krakow has been seeking other sources of financing, including a possible World Bank loan.<sup>22</sup>

Before the World Bank will commit to such financing, it has been requested that an overall feasibility study be conducted. This study, financed by the United States Technical and Development Assistance Agency (USTDA), has been awarded to CH2M Hill; work on the study commenced at end 1993. The final report, due in Spring 1994, should include technical, financial and operational recommendations to assist the City and the Water-Sewer Company (Miejskie Przedsiębiorstwo Wodociągów i Kanalizacji or WIS) in formulating a long-range water/sewer development and management plan. The recommendations should also give indications of whether those capital projects now underway and in the planning process are necessary and feasible.

One of the difficulties of the Kujawy project is that the project manager was appointed under the previous regime, and has not been supervised by the City of Krakow, which is the main investor in the treatment plant. The company which serves as project manager is receiving a 4% commission for this work. The Nowa Huta steel mills has been directly monitoring and negotiating with the contractor; the Bureau of Investments of the City supervises the work through joint inspections, monthly and quarterly reports and audits. The supervision deals mostly with financial rather than technical aspects. The objective is to verify that work has been done, but not how efficiently or well it has been done. In November 1993, the project manager was said to be on the verge of bankruptcy, which may give the City some leverage, for supervising the completion of the plant.

The technical design of plant was completed with the participation of Water-Sewer Company. Other than the technical design, it does not appear that WIS has participated in any other way in this project, such as technical supervision of the works in progress or providing financing. Evidently, it is a form of turn-key project where the ultimate operator (planned to be the WIS) has had no participation in the actual construction and would simply take over operating responsibility upon its completion.

Although the sewerage treatment plant is expected to be operated and managed by WIS upon completion, the City of Krakow has indicated that it is seeking other alternatives. These may include finding an outside management company, with foreign participation (German or French companies). The fluidity of the situation presents the possibility of a project financing approach, where the facility

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<sup>22</sup> Krakow is one of three Polish cities where the World Bank is examining making direct loans for environmental purposes, the other being Bielsko Biala and Wroclaw. See Walter Stottman, Chief Engineer, World Bank, *Baltic Sea Environmental Action Programme* March 24, 1993.

might generate its own revenues from charges to repay loans made to finance its completion or even to pay equity investors.

### **C. Transformation of WIS**

After the implementation of the local self-government act of 1990 and the transfer of State-owned utility companies to the gmina, the WIS was transferred from the status of state enterprise (Przedsiębiorstwo Państwowe) to the ownership of the gmina (Miejskie Przedsiębiorstwo). The workers are represented by a workers' council, with 27 representatives (one representative per company unit). The workers' council exercises a form of oversight over management, and can issue opinions on decisions taken by the management. In the Spring of 1993, a competitive search for the WIS Director resulted in a stalemate, due to disagreements between the City Council and the worker's council. An acting director was appointed, pending transformation of the company.

Until transformation of the company is effectuated, the City has leverage with WIS on approval of the company's budget and on the setting of the water/sewer fees. Krakow is responsible for financing all investments in new equipment, while WIS operates the system, maintains, repairs and rehabilitates the network and all related assets.

Krakow is considering the transformation of the WIS into a limited-liability company wholly owned by the City<sup>23</sup>. In this case, the executive board would be named by the City (two members) and by the company employees (one member). Agreement of all parties, including the workers' council, is required before the transformation may proceed; a social contract with the workers has apparently been pre-signed, in an effort to win their agreement. After the initial transformation of the water-sewer company, Krakow would accept evolution into a joint-stock company, with a majority holding by the municipality (51%).

### **D. Pledging of Municipal Assets**

In order to increase its creditworthiness for borrowing (from the World Bank, the EBRD or any other lender), Krakow has expressed its intention to pledge municipal assets as security for loans. It is particularly interested in this option for a possible World Bank loan to finance completion of the Kujawy sewerage treatment plant at Nowa Huta.

Some threads of initial analysis support that approach. According to the Local Self-Government Act, of 1990, "trustees of council property shall determine autonomously the purpose and mode of using elements of council property...". A resolution of the gmina council is required in cases of change of use or sale of "immovables used by the general public or serving the direct satisfaction of public needs", "of objects of special scientific, historic, cultural or natural value" and "the disposal free of

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<sup>23</sup>The company was set to be transformed at the end of 1993, but disagreements with the workers' council may have delayed the process.

charge of other elements of council property shall be subject to approval by the self-government assembly in the event of the voivod lodging an objection against the decision"<sup>24</sup>

Thus, there is no apparent direct prohibition to the pledging of gmina assets to guarantee repayment of a loan. A draft law was prepared in early 1993 on "Banking pledge by registration and on register of bank pledges"<sup>25</sup>. Article 1 indicates that the bill would refer to pledges made by State-owned enterprises, cooperatives or commercial companies; it does not refer specifically to gminas. It is not certain whether local governments would have the possibility of registering their banking pledges.

The items which may be the subject of pledge by registration and which would be most applicable to gminas include movables, monetary resources held in a banking account with the pledgee, securities owned by the pledger, existing or future marketable property rights on the pledger's intangibles<sup>26</sup>. However, before a gmina pledges property rights, the ownership rights must be verified. Is the asset pledged by the City its property, or may there still be individuals or institutions placing claims on the property?

Following the elections of September 1993 and the formation of the new Government in November 1993, it should be verified whether the new Government intends to submit this bill to Parliament for deliberation. If so, the most recent draft should be examined by the City of Krakow, and the possibility of including gminas in its provisions should be explored. Further information on the pledging of assets by gminas may likely be obtained by consulting the Ministry of Finance. The Code of Civil Procedure also applies to the issue of pledging of assets as security. In addition, competent and outside legal counsel should examine the existing laws regarding both pledging of assets and the ability to pledge or intercept payments from the central government. Along these lines, members of the team contacted the Polish affiliate of a U.S. law firm on their interest in examining the legal status of such security provisions and they have indicated a willingness to do so. We believe that this legal research done by an independent firm with knowledge of security provisions in the U.S. and international public finance markets would be most helpful.<sup>27</sup> The existence in the future of marketable local government debt will depend on securing valid, enforceable pledges of properties and revenues.

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<sup>24</sup> *Rzeczpospolita* No. 69, 22 March 1990, Article 45.

<sup>25</sup> Draft of 8 March 1993.

<sup>26</sup> *Ibid.*, Article 7.

<sup>27</sup> Discussions with Mr. Watson Seaman of the firm Huntin & Williams -Poland, Warsaw, in November and December, 1993.

## **E. Public procurement procedures**

In addition to pledges of assets by the City as security for repayment of a loan, the World Bank will also be looking at public procurement procedures followed by Krakow. The City has developed its own internal rules on public procurement which are said to follow national bidding regulations. Krakow's bidding and procurement process includes the following elements:

- # Contracts of less than 50 million PLZ<sup>28</sup> - the price and conditions of performance are negotiated with the contractor and an agreement signed (the City has prepared a standard contract form);
- # Contracts greater than 50 million PLZ - entails a bidding process for awarding the contract;
- # Contracts up to 100 million PLZ - the signatures of the City lawyer as well as of the Finance Department are required;
- # Contracts over 100 million PLZ - the signature of a member of the executive board is required, in addition to the two signatures indicated above;
- # Cost overruns (said to be the case for the majority of contracts) - the contract is renegotiated and an annex is added;
- # Non-performance - there is a penalty of 0.3 per cent per day of the value of the contract is levied;
- # Participation in a bid - constructors are required to provide financial guarantees and indicate a date of delivery.

If Krakow is the sole investor or the principal investor in a project, then the City conducts the bid and signs the agreement. If Krakow is one of the investors, but not the principal investor, then the City participates in and supervises the bidding process.

In order to gauge the compatibility of Krakow's public procurement rules with future national requirements, the City's current regulations may be compared to the draft Public Procurement Act which was prepared in Spring 1993. Due to the change of national government, it should be verified whether a more recent version of this bill has been prepared and whether this bill will be submitted to Parliament for deliberation. As noted, good procurement practices are of major concern to potential lenders to the City.

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<sup>28</sup> or less than \$2,500 US.

## **F. Additional criteria to obtain financing and establish creditworthiness**

The City of Krakow is in the process of responding to two conditions that in the case of the Kujawy facility appear necessary for obtaining financing from external sources, be they multilateral donors, domestic or international, or other private investors:

- # Feasibility study of the proposed investment, including an overall sectoral review and an analysis of long-term development capacities. This study should demonstrate the necessity and usefulness of projected investment, and be comprised of appropriate technical studies and documentation, financial plans and projected budget for operation of the equipment.

*A water-sewer sector feasibility study has been contracted to CH2M Hill, and should be completed towards mid-1994.*

- # Conformity with and adherence to national (proposed) public procurement legislation. If the City develops public procurement criteria which are more stringent than national regulations, it must be certain that there is sufficient enforcement capacity.

*Krakow appears to have developed stringent public procurement procedures. The actual regulations should be examined closely and capacity for enforcement of procedures verified. In the case of Kujawy improvement, there appears to be loose contract administration and oversight, which is most likely a relic of the past regime.*

Other criteria regarding the Kujawy project which still may need to be addressed by the City include:

- # Presentation of a global multi-year financing plan for the project and proof that financing for the remaining part of the investment (in addition to the portion to be financed by the loan) has been obtained (including the City's own contribution). This estimate of complementary financing must be realistic. In the case where tariffs or taxes must be raised, there needs to be a demonstrated commitment of the City Council to the project and to making required fiscal adjustments as will be necessary.

- # Clear/transparent legal and financial relationships between the public utility /service provider and the gmina, and demonstration that the public utility has complete management autonomy and is not subject to political checks by elected officials.

Other steps that would enhance the City's creditworthiness involve efforts in the area of financial reporting and management and include:

- # Modification of the procedures followed to prepare municipal budget. Modified presentation of accounts and financial reports, with, at a minimum, a distinction between capital and operating sections, program budgets, and the use of self-balancing, restricted funds.

*The expected introduction by the City of Krakow of a complete financial computer package, including fund accounting and encumbrance accounting will place the City in an advantageous position. There appear to be some delays in implementation, however. The City should, nevertheless,*

*continue to think through the objectives and expected results of modified financial reports and what needs to be achieved to meet these objectives (i.e. -implementation of program budgeting or another form of management-oriented budgeting)*

- # Demonstration that revenue collection procedures (public utility tariffs and fees, as well as tax revenues) are efficient and effective. If there are problems, a program and timetable for improvement should be established. Aside from the training programs discussed later in this document, technical assistance may eventually be obtained from a Municipal Development Agency or another Polish or multilateral institution.
- # If already available, the report of the audit conducted by Regional Accounting Chamber (RIO), indicating proper accounting and financial practices and, if prepared, a separate opinion on the debt carrying capacity of the gmina).
- # Strong, transparent security for the repayment of loans, through 1) black box or specific bank account to capture and direct revenues from project to repayment of loan; 2) pledging of gmina assets, and 3) use of general subsidy as a repayment guarantee, through an agreement signed with the Ministry of Finance (if the new Government has included this option in the gmina finance law),

*Krakow's inquiries into possibilities of intercepts of intergovernmental payments and other revenues and the pledging assets as loan security are important steps to meeting these criteria.*

- # Gmina finances and project finances will need to be responsive to some financial analysis ratios (i.e. existing debt, measure of potential of revenue generation, share certain types of expenditures in percentage of operating budget); and medium-term budget forecasting would identify general trends of gmina finances.

*The modified presentation of accounts should facilitate identification and calculation of these ratios.*

## **G. Conclusion**

Several emerging issues for the City of Krakow are converging to decision points this spring. The active interest of the World Bank and the ERDB in financing the completion of Kujawy sewer treatment plant will be brought to an important threshold by the completion of the CH2M-Hill's feasibility study. Among other things, the report may facilitate a resolution of the administrative/structural stalemate between the gmina and WIS. An important aspect of the new structure may be the leverage that could be exerted by the City in considering the use of a project financing approach whereby Kujawy would be, in effect, a separate entity for purposes of operations (which it might contract for from private firms or, perhaps, WIS) and for the financing. Use of a project financing approach might rapidly accelerate the financing of the improvement and also provide the opportunity to put in place important precedents regarding subnational investment financing initiatives.

An important consideration, aside from those steps regarding procurement, financial reporting and disclosure which the City is currently working on, is formulating what is available to the City (and/or the project) in terms of security for a borrowing. Here, a number of alternatives should be developed and compared for possible implementation. Major questions that need to be resolved are the ability of the gmina to guarantee the indebtedness of affiliated or separate entities, the ability to pledge specific revenues, the pledging of intergovernmental payments (interceptions), the pledging of properties (discussed in the text above), and the use of third-party trustee relationships. Each of the above areas should be subject to competent and independent legal analysis and the City should be independently assisted, as well, in sorting through the opportunities for and implications of various financing plans. We note that the City has been approached by private companies interested in collateralized financings (Nikko securities) and has contacted on its own a variety of potential funding sources for the Kujawy project. Independent analysis of these proposals on behalf of the City would be most desirable.

## **IV. OUTLINES OF TRAINING PROGRAMS**

### **A. Introduction**

In-service training is a pressing need in Polish municipalities. As responsibilities are reshuffled and new systems using new technologies are devised, new structures and procedures are called for. This is especially true in the area of financial management. At the same time, it must be realized that many in the public work force are veterans of the old regimes and succeeded under the old way of doing things. With the intense economic pressures and the universal concerns of continuing to keep jobs, training efforts pose a particularly personal dilemma. Participants need to see that making a personal investment is desirable and that those that can master change will be in a better professional position. The alternative is that without that mastery, positions in the bureaucracy will be more tenuous and employability will be reduced.

The following training programs or modules are generic in nature and are intended for in-service instruction and skill-building for public servants. Properly modified, they can be used for their supervisors and elected officials. They are intended to be one-to-two day events that would take participants through the stages of general concepts and into the specific skills required to design and administer effective financial management systems. The discipline focuses are on accounting, procurement, revenue and budgeting programs. Guidance provided by the training course should be both conceptual and practical to enable course participants to develop understanding and qualifications in these areas. The course should use as its underlying theme the specific needs present in local governments in Poland, and clearly polish-speaking instructors should be used as much as possible. While adaptations of widely accepted principles in public financial management are used, the course should always come back to those skills required to provide effective service delivery and infrastructure financing in Poland. Experience shows that translated documents from U.S. local governments can be extremely useful in starting up new systems and providing ideas.

The format for the training course will be a combination of lectures, group discussion and practical exercises. Theory will be presented through lectures, theory should then be adapted to specific conditions in group discussions. Specific skill-building will be accomplished by conducting practical exercises and case studies on each subject area. As noted, the courses are designed to be generic and foster appreciation and understanding of how particular disciplines fit into public financial management. They are not intended as full-blown academic instructional curricula, which should be done in conjunction with universities and institutes designed for that purpose. In the narrative text we have highlighted the principle concepts that should be contained in respective courses.

### **B. Budgeting**

For this training module, the budgeting process was examined and the training requirements were identified. The course will define and tabulate, in the form of a proposed curriculum for training

staff in the budgeting process, the findings of the examination, addressing the requirements identified in the examination phase.

To train people in the process of budgeting, it is important to teach them first, the theoretical aspects of budgeting and then the practical and technical requirements for preparing effective, meaningful budgets for their political entities. We see the budgeting training seminar having two distinct phases. The first phase will be conceptual and the second practical preparation of a budget.

For the conceptual part of budget training, the lecture and group discussion with exercises methods should produce the best results. Before we embark in the content of the training course, let us examine what the desired results are.

First, participants should comprehend the importance of the budget as a means of allocating the use of scarce resources in an effective and efficient manner. Second, participants should obtain specific skills to prepare budgets that reflect real conditions and political decisions, regardless of special circumstances which will inevitably appear as the economy develops. Third, the course will assist participants to master the budgeting process, which in turn, will make participants more employable and valuable in the management of local government finances. There is a need in other words to build self-esteem in the process of building skills and to show how those skills are important to the individual.

Budgeting is divided in two categories: **Operating budget** and **capital (or investments) budget**. It is also important to explain the distinction between the budget as a legal **document** that authorizes activity and budgeting as a **process** by which that document is generated.

### ***1. The Operating Budget***

The operating or current fiscal period budget is the result of the budget process and it assists a government in making **resource allocation decisions** for the provision of public goods and services. In preparing the budget, public sector employees make important decisions and play a significant role in the framing the allocation questions and showing resource needs for various spending alternatives. Typically, employees are more isolated from public demands for services than elected officials. The goal of a budget is to provide the public with the amount and the quality of services it desires, within the community's resource restrictions and the lowest possible cost. The concepts of **efficiency, effectiveness, and equity** should be discussed and illustrated. A budget helps a government allocate **public goods**. For a newly-created market economy, we feel it is necessary to spend some time introducing the concept of public v. private goods and services. The determining characteristics will be presented and a discussion will follow to identify such public goods and services that are assigned to local governments for management and distribution. Once these have been identified, the process of allocating resources (revenues) among uses (expenditures) -- the budgeting process -- will be presented.

For budgets to be transparent, understandable and useful the following requirements must be met:

- # The budget is based on reliable, accurate and relevant financial information.
- # The budget is based on accurate economic forecasts.
- # The budget is reflective of community desires, as expressed by the election process.
- # The budget is operating within the existing legal parameters.

The operating budget process must have a consistent, specific form. This form starts with the establishment of a functional **budget cycle**. The components of the budget cycle should be introduced and discussed, and a **calendar and various forms** for preparing an effective budget illustrated. The budget cycle usually contain four stages.

- # Preparation by appropriate authorities, typically the executive branch of government.
- # Consideration by elected legislators and adoption.
- # Execution and monitoring.
- # Review, audit and evaluation.

Examples of each stage will be provided and exercises will be used to demonstrate the functionality of each stage, as well as the relationships among the stages.

Next, the course will treat the **financial contents** of budgets. These include the budgeted expenditures by governmental function and type, the revenues estimates and the cash forecasts for a budget period. **Expenditures** are a function of the areas that a local government is responsible for providing goods and services to its citizens. Once these have been identified and instituted, the categories will be established based on a government's chart of accounts and organizational structure. The course will provide the class with illustrations of classifications for governmental expenditures for different types of local governments.

Next, the course will address budgeting for **revenues**. The revenue portion of the budget reflects the anticipated revenues for the budget period. It is often an area of debate, since revenues and changes in revenues are subject to political and economic fluctuations outside a local government's control. The course should provide class participants with methods for **estimating revenues** based on existing tax structures and the use of forecasting techniques that can be adjusted to reflect the level of sophistication attainable in various environments. Most important for revenue forecasts is the ability to perform accurate "what-if" scenarios to assist political leaders in the decision making process when changes in revenue composition are examined. The factors that need to be considered when contemplating changes in a local government's revenue sources will be presented and discussed. Sample what-if scenarios and analyses will be performed as exercises, and the results will be interpreted by the participants.

The forecast of a government's **cash position** is important because it allows for the proper management of financial assets. This includes development of investment strategies, establishing borrowing requirements and procedures and providing for emergencies and contingencies to avoid fiscal crises.

The implementation and administration of the enacted budget will be the next topic of instruction. In this segment, the course will cover methods and techniques employed by governmental entities for managing the budget once it has been enacted. The concepts of **authorization, allocation, allotment, and recession** will be presented. Laws and governmental regulations and policies regarding procurement and modification of budgets cover the execution of the budget. Techniques and samples of workable regulations will be presented and discussed as part of this course.

**Audit, review and evaluation** conclude the budget cycle. This step plays an important role in the process because it provides for the integrity and transparency of the budget and allows governments to identify problem areas. The concepts of pre-audit and post-audit are discussed. Financial, operational, program and performance audits will be presented and discussed in class. An exercise for each type of audit should be prepared and administered as final step for this section.

## ***2. The Capital Budget***

This course, which may be part of the overall budget course or conducted separately, should examine the process of budgeting for capital projects, how it differs from the operating budget process, and how a capital budget document is prepared and interpreted.

First, the course will introduce the **capital improvement plan (CIP)** concept. The course will examine what is a capital improvement plan, why is a capital improvement plan necessary and, finally, how does one go about preparing a CIP. The CIP is a multi-year financing and physical plan (usually 5 to 6 years) that is the basis of the capital budget, which typically is the current-year segment. The course will discuss use of the CIP to prepare a capital budget which then can be incorporated in a government's annual budget.

Capital projects, by their technical and economic nature, should require long-term planning. Before we begin with the CIP concepts, the course will introduce basic concepts of capital planning, the interrelationship between physical and fiscal requirements, and problem areas in the planning process unique to Poland's local governments. Because capital planning requires **integration of physical and financial planning**, the course will identify appropriate departments at the local or national government level that need to be involved in the CIP process. Next, the course will introduce the components of a CIP, and will outline the process for preparing the document describing the CIP.

After the CIP process has been introduced and discussed on general terms, the course will discuss the benefits of capital budgeting and will outline major differences between capital and operating budgets. In this section the concepts of improved efficiency, cross-generational equity, stabilization of tax rates, the permanence and high cost of capital projects, and the value of capital budgets in the

management process of public resources will be identified, explained and discussed. The final step for the introductory section of the capital budgeting class will be exercises through which students will be asked to identify key components of the capital improvement process, to defend the existence and creation of CIPs and capital budgets and to outline the benefits of having separate capital budgets.

For the next section of the capital budget course the course will describe the capital budget process. While this process can vary and should vary to address specific needs present in different economic and infrastructure needs environments, the underlying concepts should remain stable for a capital budget to be effective. Specifically, capital budgets need to address:

- # The selection of capital projects from the multitude of alternatives,
- # the timing of the expenditure and the means to finance it,
- # the effect of the change in capital stock on a local government's finances.

After covering the basic concepts of capital budgeting, the course will discuss with the class common problems found in the capital budgeting process and specific problems facing local governments in Poland (such as inflation and fiscal stringency).

After we have covered problem areas, the course will begin exercises aimed at creating a capital budget document. The concepts of **cost benefit analysis** and **life-cycle costing** will assist the selection process of capital projects. Cost benefit analysis and the use of **selection criteria** for capital budgeting is typically made up of five steps:

1. classification of desired project objectives,
2. evaluation of project impact on objectives,
3. quantification of costs and benefits over the project's useful life,
4. discounting cost and benefit flows to their present value,
5. methods of presenting results in an understandable fashion.

After these five steps have been introduced, a discussion will follow to discuss methods of financing of capital projects and the concepts of **pay-as-you-go** versus **debt financing**. The final step for the class on capital budgeting will be an exercise where participants will use the concepts and skills learned in the class to prepare a short fictional capital budget.

### C. Accounting and Financial Reporting

An important part of effective financial management is the accounting and reporting of a governmental unit's financial operations. The main objective of an accounting system is to provide information that can be translated into understandable, comprehensive financial reports that can meet multiple needs. As such, accounting and financial reporting systems are related and an essential part of a government's operations. This section of the course will focus on providing training and practical exercises to participants on the subject of accounting and reporting financial operations of a local government. While it is not a comprehensive course, it is meant to give an appreciation of the following:

1. Design financial system of records,
2. record activity on such a system,
3. use financial information to create financial statements,
4. interpret financial information,
5. give advise on financial matters,
6. assist with management and policy decision-making.

The course will begin with a section on basic accounting and **bookkeeping principles**. In this part, participants will be taught rudimentary skills of bookkeeping and basic accounting principles. Topics covered will include: General ledger creation and management, record keeping for changes in financial position, and balance sheet accounting. Next, the course will introduce the concept and basic principles of fund accounting. The course will discuss various ways to aggregate governmental funds, their legal parameters and the accounting principles associated with aggregation. The course will also introduce examples of fund categories and fund types commonly found in governmental operations and structures of organization. Such structures typically include general fund, specific revenue fund, capital projects fund and debt service fund categories. Characteristics of each fund type and organizational requirements will be presented and discussed. Group discussion and exercises on the principles of accounting in general, and fund accounting in particular, will conclude the introductory section of this segment.

The next segment of the **financial reporting** segment will focus on fund accounting and financial reporting. In this section, the course will examine the subject of **fund accounting**, with emphasis on the creation of accounting systems that can provide accurate and dependable information. Methods of creating such systems and the criteria that need to be examined will be presented and discussed. The course will instruct participants on how to: Identify, describe and record valid transactions, classify transactions according to system parameters, determine the time period in which transaction occurred, and report the transaction in financial statements.

This course will also cover the **basis of accounting**. The course will introduce the concepts of **cash accounting, accrual-based accounting** and **modified accrual-based accounting**. The course will identify differences and similarities among the three main types of accounting and will discuss the benefits and disadvantages of each type. Emphasis will be given to the **measurement focus** that is appropriate for each fund type and a fitting exercise to the proper accounting basis will follow. Since the accounting basis depends largely on the timing and manner of recognizing revenues and expenditures, the participants should acquire hands-on practice in creating examples of various fund types with appropriate accounting bases.

The course will also provide participants with skills to **control accounting functions** to ensure the integrity of the operation. The parameters for creating policies and procedures and for administering these policies will be introduced and discussed. Such policies include: Authorization requirements for entering and/or altering transactions and activities, segregation of duties among different areas and hierarchical levels of the finance department, creation of adequate documents and records to support historical records, maintaining and safeguarding records and transactions, performing independent checks and tests to ensure the integrity of the system.

After the second segment is completed, the course will open the class to discussion to identify specific areas of concern among the participants and will adapt the methods learned to introduce workable solutions for the key problem areas.

The course will follow the accounting section with the **financial reporting** segment of the course. First, the course will cover the principles of financial reporting. In doing this, the course will identify and analyze objectives and parameters for financial reports. Basic principles of financial reporting objectives can be introduced and discussed as a starting point for creating reports that are understandable, reliable and consistently available. The basic objectives of financial reporting to be covered will include:

- # Reports should be understandable by readers and easily interpretable to assist decision and policy making.
- # Reports should provide adequate information to assist users in evaluating the financial results of a government's operations over a specific period of time.
- # Reports should provide guidance for assessing the level of services a government can provide its citizens and the government's ability to finance these services.
- # Reports should demonstrate that resources were obtained and used in accordance with the government's budget and other legal or contractual requirements.
- # Financial reports should also provide information about the sources and uses of financial resources and changes in a government's financial position for a specific period.

- # These and other related objectives will be analyzed and, through group discussion, a priority list for financial reporting requirements will be developed to reflect the needs of local governments in Poland.

Finally, in this section of the course, the course will instruct participants on how to use accounting and financial information to prepare **financial reports**. This section will focus on the methods and techniques used to combine general ledger information and transaction data into schedules, account group statements and combining and combined general purpose financial statements. The preparation of condensed summary data and executive summary reports and presentations will be covered to assist participants in communicating financial results to interested parties in a consistent, concise and understandable form. After instruction is completed, participants will be assigned to groups with each group having responsibility to present to class segments of financial reports and executive summaries.

#### **D. Procurement Procedures**

This course will instruct participants on the concepts and practices of procurement for governmental entities. Specifically, the course will address three areas of the procurement cycle:

- # Scheduling and planning government purchasing.
- # Selecting vendors and procuring transactions.
- # Contract administration and management of service providers.

First should be discussed **organizational considerations** of a government's purchasing department. The course will describe various structures of such departments (centralized, decentralized, etc.) and will provide class participants with the tools necessary to evaluate each structure and design a purchasing department that best fits a government's structure and purchasing requirements. The course will also address legal and authorization mechanisms that can make the purchasing process more efficient, open and honest.

First, the course will address the responsibilities of a typical local government procurement department. These responsibilities usually include:

- # Assisting governmental agencies and departments with the selection of purchasing methods, the development of requests for proposals (RFPs), and development of proposal evaluation methodologies
- # Develop decision criteria to determine goods and services that should be provided by external providers
- # Participate in the bidding and bid evaluation process

- # Creating and maintaining lists of potential vendors
- # Coordinate planning, scheduling and inventory of goods and services acquired in the open market
- # Advise management on market conditions, new technologies and products

After we have covered the organizational structure and role elements of a procurement division, the course will move the class on to a typical purchasing process and initiate discussion to identify goods and services that are currently provided by local governments in Poland, and could be acquired in the open market more effectively and at a lower cost.

Next, the course will examine a typical purchasing cycle for a product identified in the previous discussion. The purchasing cycle topics will include:

1. Requisition creation and submission.
2. Requisition verification and approval.
3. Analysis of user needs and requirements.
4. Analysis of legal and regulatory requirements.
5. Examination of cost-effectiveness criteria.
6. Identification of potential sources of supply.
7. Selection of procurement method.
8. Creation and dissemination of solicitation document.
9. Evaluation of bids and selection of vendor.
10. Award and management of inventory or service contract.

The course will conclude with an exercise that will require participants to outline the ten steps of purchasing for a specific good or service necessary for the proper operation of their local government. Participants will also be required to define the improved efficiencies of open-market procurement and the problem areas of the open-market procurement process.

## E. Revenue Administration

This section of the training course will address the topic of creating and managing effective revenue administration structures and procedures for a local government. Local governments derive revenue from their own sources or from other governments. Own source typically means taxes on income, property or commercial activity or fees charged to users of goods or services. Intergovernmental revenues are transfers from other governments. Since the creation and effective administration of revenues dictate the income of a local government, it is important to have in place dependable revenue management systems. This course will teach participants the basics of revenue management and will provide participants with examples of effective revenue administration systems. While administrators do not usually dictate policy, it is essential that they provide policy makers with good information and dependable systems to carry out the revenue collection laws and regulations.

The class will teach participants the criteria for evaluating tax policy. The discussion of tax policy will continue with the introduction of criteria for judging taxes based on the principles of **efficiency**, **equity**, **effectiveness**, and **neutrality**. The class will discuss the criteria and will apply practical experience of current systems to the criteria test to identify areas of weakness in the current revenue collection structure. Criteria for evaluating tax policy and administration will include:

- # Ability to pay
- # Benefits Received
- # Horizontal equity
- # Vertical equity
- # Adequacy of revenue
- # Collectability
- # Economic effects

After these topics have been introduced, class discussion will follow to determine applicability of criteria for revenue systems used by local governments in Poland. Alternatives and their inputs will be discussed. Class participants will also be given exercises to help them identify key characteristics and compare their own tax structure to other systems. Next, we will cover the procedural elements of a **revenue administration** system. These elements include:

- # Collection methods
- # Delinquent account management

- # Criteria for selecting depository banks
- # Content and frequency of collection reports
- # Criteria for evaluating collection system

Well-proven methods used by local governments elsewhere to administer different types of revenue structures will be introduced and discussed. The costs of and procedures for **tax forgiveness** and **abatements** will be discussed. The class will be provided with sample forms and policies for each element of the administration system. Forms and model policies will be provided for income tax, consumption tax and property tax systems. Discussion will follow to determine the steps to be taken to adjust policies and procedures for local governments in Poland. Emphasis will be placed on the collection method segment of the tax cycle. The tax processing flow will be introduced and the class will be asked to identify elements of the processing flow that could benefit from automation and/or changes in current practices.

Finally, the participants will be asked to participate in exercises focusing on the administrative structure and operations of a revenue system.